S. Hrg. 103-693

NOLHGA BAILS OUT A HEALTHY INSURANCE COMPANY

HEARING

BEFORE THE

SUBCOMMITTEE ON ANTITRUST, MONOPOLIES AND BUSINESS RIGHTS

OF THE

COMMITTEE ON THE JUDICIARY UNITED STATES SENATE

ONE HUNDRED THIRD CONGRESS

FIRST SESSION

ON

EXAMINING THE CURRENT SYSTEM THE STATE GUARANTY FUND SYSTEM USES TO PAY OFF INSURANCE POLICYHOLDERS

JUNE 29, 1993

Serial No. J-103-19

Printed for the use of the Committee on the Judiciary

U.S. GOVERNMENT PRINTING OFFICE
82-604 CC WASHINGTON : 1994

For sale by the U.S. Government Printing Office
Superintendent of Documents, Congressional Sales Office, Washington, DC 20402
ISBN 0-16-045821-8

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NOLHGA BAILS OUT A HEALTHY INSURANCE COMPANY

TUESDAY, JUNE 29, 1993

U.S. Senate,
Subcommittee on Antitrust, Monopolies and Business Rights,
Committee on the Judiciary,
Washington, DC.

The subcommittee met, pursuant to notice, at 9:38 a.m., in room SD–628, Dirksen Senate Office Building, Hon. Howard M. Metzenbaum (chairman of the subcommittee) presiding.

Also present: Senator Thurmond.

OPENING STATEMENT OF HON. HOWARD M. METZENBAUM, A U.S. SENATOR FROM THE STATE OF OHIO

Senator Metzenbaum. The hearing will come to order. Events during the last 3 years have given insurance policyholders many reasons to question the soundness of their insurance companies and the safety net provided by their State guaranty funds.

Several giants of the life insurance industry, like Executive Life and Mutual Benefit, have fallen. Many smaller life companies have been taken over by regulators. Household-name property and casualty insurance companies with multi-billion dollar portfolios couldn't withstand Hurricane Andrew, and are now withdrawing from the home insurance market or are substantially curtailing the number of homes they insure. State legislatures are struggling with special financing mechanisms to enable their State guaranty funds to pay off policyholders.

This subcommittee has evaluated many of these developments, including the inadequate protection provided by our State guaranty funds. So, 14 months ago when this subcommittee conducted its first oversight hearing on the State guaranty fund system, I thought we had heard the worst of the problems. But now I know we only scratched the surface.

At that 1992 hearing, we learned that the guaranty funds have insufficient assessment capacity to cover the losses associated with a major failure. The GAO told us about their patchwork coverage and their failure to provide timely payments to policyholders of insolvent companies. And we learned, notwithstanding industry claims, that insurance companies do not foot the bill for the guaranty funds. I want to emphasize that. Insurance companies do not foot the bill for the guaranty funds. To my utter amazement, we were told that 79 percent of insurance company payments to guar-

anty funds are written off, dollar for dollar, against the taxes that these same insurance companies owe the State.

Having the taxpayers of a State bear the cost of the guaranty fund is just not fair. For example, middle- and low-income taxpayers cannot afford expensive tax-shelters, such as single premium whole life policies. So, they should not pay for guaranty fund coverage if the company offering the product fails. Many taxpayers have no insurance and realize no benefit from a guaranty fund. The cost of insurance company failures should be borne by the companies, not the taxpayers of a State.

It took this subcommittee another year of investigation and surveys before an accurate picture of our guaranty fund system became clear. And it is not a pretty one.

In order to create a national guaranty system to address national insurance company failures, the State guaranty funds have become mere check writers. They have delegated all other meaningful responsibilities to the National Organization of Life and Health Insurance Guaranty Associations. NOLHGA, as it is known, is a private organization, answerable only to its board of directors of nine insurance company executives.

Even though NOLHGA is the brain and body of the system, and effectively tells the State guaranty funds what to do, not one governmental agency reviews its operations. In fact, when this subcommittee's staff requested the names of the board members of the State guaranty funds, they were told that the list could not be made available. NOLHGA is accountable to no one.

In this clear, new picture, we found that each of the State guaranty funds are controlled by insurance company executives and consultants. In fact, 98 percent of the board members of the 52 life/health insurance guaranty funds are from the industry. And, worse yet, 35 percent of these industry board members do not even reside or work in the State of the fund they direct.

Listen to this: Executives of the Prudential Life Insurance Co. serve on 26 separate life insurance guaranty fund boards. One Prudential vice president serves on seven separate boards. Executives of the Metropolitan Life Insurance Co. serve on 20 separate life insurance guaranty fund boards. One Metropolitan executive who works in New York, serves on the boards of the Alabama, Delaware, Florida, Louisiana, Missouri, and New Jersey guaranty funds.

Here is another part of the picture: The total control exercised over the guaranty funds by these industry representatives is unchecked. As a result, industry mistakes are covered up and industry inefficiency paved over.

The last part of the picture is possibly the ugliest—the rampant conflicts of interests. For example, guaranty funds are housed in and staffed by insurance companies and consultants. And insurance executives vote on guaranty fund business that significantly affects their financial interest. Frankly, we should expect nothing less when we allow the regulated industry to control the guaranty system that spends taxpayer dollars to bail out the industry's failures.

Based on this subcommittee's investigation, and the case we will examine today, there is little doubt that our guaranty fund system

is seriously mismanaged and compromised. It is also clear that our guaranty fund system must undergo major reform.

During our hearing today, we will hear from two panels. With the second panel we will discuss the major problems the subcommittee's investigation and survey have documented. We will specifically examine the extent to which NOLHGA and the guaranty funds are controlled by the industry and whether they are accountable to the public.

With our first panel we will examine why our guaranty fund system, which is designed to bail out failed companies, instead bailed out a solvent, A-plus rated company, Security Benefit Life. From this case study we will see the serious consequences for State taxpayers of a guaranty fund system which allows industry controlled and operated boards to spend taxpayer dollars with little or no accountability.

One reason the public, as well as the press, know so little about cases like Security Benefit Life is that they involve complicated details that can only be learned by sifting through the records of NOLHGA. And NOLHGA does not allow the public to evaluate its performance.

Because the story of the bailout of Security Benefit Life involves so many parties and dates, I will briefly describe what happened. These events are listed in more detail on the chronology attached to my opening statement.

In 1987, Security Benefit Life, an A-plus rated company, transferred a $30 million block of annuities to a Pennsylvania life insurance company that Security Benefit knew was unrated and in shaky financial health. Security Benefit did not ask nor get consent from the 3,000 annuitants. Shortly, thereafter the Pennsylvania company transferred the same annuities, again without the consent of the annuitants, to an Arizona life insurance company. Within months, the Arizona company went bankrupt. The Arizona Guaranty Fund declared it was not responsible for the annuities, because they had been transferred to the Arizona company without policyholder consent. According to the guaranty fund, the company never assumed liability because the policyholders never consented to the transfer.

Within 6 months, the annuitants began a class action lawsuit against Security Benefit, alleging that it was liable for the annuities because the annuitants had never consented to the original transfer. Security Benefit immediately went to NOLHGA and the NAIC and asked for the guaranty funds to do two things. One, step in and pay off the annuities; and two, waive any right to sue Security Benefit. They quietly obliged, spending $23 million of State taxpayer money to pay off the liability of a solvent, well-capitalized company.

The postscript to this story is that 10 months after Security Benefit, NOLHGA and the guaranty funds reached their agreement, a Federal court in Kansas found Security Benefit liable for the annuities.

We are here today to get answers to why the guaranty funds spent taxpayers' money to bail out a solvent company.

I'm very pleased to see my colleague and friend, Senator Thurmond, here with us this morning. Senator Thurmond, do you have an opening statement?

OPENING STATEMENT OF HON. STROM THURMOND, A U.S. SENATOR FROM THE STATE OF SOUTH CAROLINA

Senator THURMOND. Yes. I might say that I went to the Hart hearing room and waited there a good while because nobody told me about the change of the place of the hearing.

Senator METZENBAUM. Don't feel bad because if somebody hadn't been with me I would have gone to the same place. They didn't tell me, but they just led me by the hand.

Senator THURMOND. The committee ought to notify us so we'll know where to go.

The hearing today concerns the operation of State insurance guaranty funds for the life and health insurance industry, and the National Organization of Life and Health Insurance Guaranty Associations, which performs the multi-State coordination of State insurance guaranty funds. This subcommittee held hearings on insurance guaranty funds last year on April 28 and May 5, 1992. Unlike last year, today's hearing is not intended to focus on the requirements for obtaining the consent of policyholders for assumption reinsurance. They key issue today is whether there are improper conflicts of interest in the operation of NOLHGA and the State guaranty associations.

Guaranty associations are created to cover the obligations of insolvent insurance companies to policyholders and their beneficiaries. It is my understanding that all 50 States and the District of Columbia now have life and health insurance guaranty associations. Guaranty associations are governed by boards of directors. Most directors for guaranty associations come from the insurance industry, which raises the possibility of conflicts of interest.

The potential conflicts resulting from directors who work for insurance companies might be expected to result in fewer payments from the guaranty funds. This might be the result because all payments by a guaranty fund are assessed against the insurance companies in the State, and any tax benefits from paying the assessments are only available over a number of years. However, Mr. Chairman, you apparently have concerns about whether the guaranty associations have been too quick to make payments and enter settlements to protect policyholders, without pursuing every possible remedy to avoid liability.

Today's hearing focuses on annuities transferred by Security Benefit Life, which was also the subject of a hearing last year before this subcommittee. I believe it is open to question whether this case illustrates any conflict of interest or impropriety by NOLHGA or the State guaranty associations. Nonetheless, it may be beneficial for this subcommittee to consider whether the guaranty associations are operating as well as they possibly can.

The Security Benefit case involves annuities which Security Benefit assumed from a weak insurer, First Pyramid, and later transferred to Life Assurance Co. of Pennsylvania. LACOP subsequently transferred the policies to Diamond Benefits Life. After LACOP and Diamond became insolvent, there was substantial uncertainty

about who had liability for the annuities, which resulted in complex litigation in multiple courts.

In order to protect the annuity holders, NOLHGA and State guaranty associations were able to bring about a settlement involving Security Benefit that fully covered the annuity holders. To this extent, it seems clear that the State guaranty system was successful and achieved a desirable outcome. Without the settlement, there would have been protracted and expensive litigation, which would have been particularly harmful to the annuity holders.

As you know, Mr. Chairman, I am very supportive of the States' role in insurance. I continue to believe that State regulation and control, while not free of problems, are far more responsive to consumers than Federal systems could ever be. However, I also believe there are certain issues within the insurance industry that warrant occasional oversight on the Federal level. The status and health of the guaranty associations is one of those issues, because of the importance of these State funds in protecting individual policyholders and maintaining consumer confidence in the insurance industry.

Mr. Chairman, while you and I may disagree on the need for Federal involvement in the insurance industry, we can agree that this hearing will provide useful information about the industry. Hopefully, this hearing will help inform and alert State regulators, State guaranty associations, and individual policyholders to any issues which may need attention in their own States. I look forward to hearing from the witnesses this morning, and thank them for their time and effort in being here.

Thank you, Mr. Chairman.

Senator METZENBAUM. Thank you very much, Senator Thurmond. We're very pleased that you're with us here this morning, and you certainly are assiduous in attending and participating in committee hearings and we're grateful to you for that.

Would the witnesses be good enough to stand so that I may swear them in?

Do you solemnly swear to tell the truth, the whole truth, and nothing but the truth, so help you God?

Mr. BLAINE. I do.

Mr. SIMMONS. I do.

Mr. DUMMER. Yes.

Senator METZENBAUM. Mr. Blaine, do you have an opening statement?

Mr. BLAINE. I do, Mr. Chairman. Thank you.

Senator METZENBAUM. I think you know we have a 5-minute rule on statements.

Mr. BLAINE. Yes, indeed, and I will abide by it, Mr. Chairman.

PANEL CONSISTING OF JACK H. BLAINE, ESQ., PRESIDENT, NATIONAL ORGANIZATION OF LIFE AND HEALTH INSURANCE GUARANTY ASSOCIATIONS, HERNDON, VA; DAVID SIMMONS, EXECUTIVE VICE PRESIDENT, NATIONAL ASSOCIATION OF INSURANCE COMMISSIONERS, KANSAS CITY, MO; AND ARTHUR O. DUMMER, FSA, FORMER CHAIRMAN OF THE BOARD, NOLHGA, AND MANAGING SECRETARY, UTAH LIFE AND DISABILITY INSURANCE GUARANTY FUND, SALT LAKE CITY, UT

STATEMENT OF JACK H. BLAINE

Mr. BLAINE. Good morning, Mr. Chairman, Senator Thurmond. My name is Jack Blaine, and I'm president of the National Organization of Life and Health Insurance Guaranty Associations, NOLHGA. NOLHGA is a voluntary association of the 50 State life and health insurance guaranty associations as well as those serving the District of Columbia and Puerto Rico. Our primary function is to work with rehabilitators and liquidators to facilitate meeting the statutory obligations of the various State guaranty associations.

I appear here today at your invitation to discuss the global settlement entered into between several State guaranty associations and Security Benefit Life Insurance Co. to provide a resolution of a problem encountered by owners of ValuBuilder Annuities. You've also asked that we discuss the control and accountability of State guaranty associations to the public and the State departments of insurance.

All States, the District of Columbia, and Puerto Rico, as Senator Thurmond has noted, have enacted legislation based on the current or earlier versions of an NAIC model life and health insurance guaranty association act. That act has as its purpose the protection of beneficiaries and owners of life insurance and health insurance policies and annuity contracts. Each State's law creates a guaranty association and membership in the association is required of all insurance companies licensed in that State to write the covered lines of business.

State guaranty associations are governed by a board of directors selected by member insurers, subject to the approval of the State insurance commissioner. Board members serve without compensation but are reimbursed expenses of travel for meetings. Last week at its June 1993 summer meeting the guaranty fund subcommittee of the NAIC; that is, the National Association of Insurance Commissioners, approved an amendment to the model act to provide for the inclusion of two public representatives on guaranty association boards. Those boards typically range in size from five to nine members.

In addition to approval of board members by the insurance commissioner, the association must submit annual reports to a State insurance commissioner. In addition, the commissioner may assume the powers and duties under the act when the guaranty association fails to take action with regard to an impaired or insolvent insurer within a reasonable time. In other words, the commissioner may take over the guaranty association functions when it fails to take prompt action.

When a member insurer becomes financially insolvent, the association is called upon to provide protection for policyholders and beneficiaries. Claims against the insolvent insurance company are covered up to specified maximums, usually $300,000 in death benefits, $100,000 in cash value life insurance, $100,000 in health insurance benefits, and $100,000 in the present value of annuities. The model act requires that the guaranty association continue coverage in force consistent with the rights of the policyholder.

This obligation to continue life insurance, health insurance, and annuities is perhaps a major distinction between this insolvency protection system and ones for property liability insurance or for depositor to banks or other financial institutions. To provide the funds needed fulfill these obligations to covered policyholders, the act provides for assessments against member insurers in proportion to each of their respective shares of the premiums written in the State on the covered policies and contracts.

In summary, the statutes set forth the obligations of State guaranty associations in terms of the benefits to be provided and ultimate accountability is to the insurance buying public.

Now, as to the ValuBuilder Annuity case, the history of this block of business has already been made a matter of record before this subcommittee in testimony at your hearing last year. Briefly, this is a block of annuity contracts that was first acquired by Security Benefit Life from First Pyramid Life Insurance Co., an Arkansan insurer that was experiencing financial difficulty. The block of annuities was sold by SBL to Life Assurance Co. of Pennsylvania in 1987, and in 1988 LACOP transferred the contracts to Diamond Benefit Life.

Shortly afterward LACOP and DBL both were taken over by their respective State insurance regulators and both State receivers took the position that the other had liability for the annuities. NOLHGA did not become officially involved until late in 1990, although there had been informal contacts and discussions with NOLHGA staff in the fall 1990 regarding possible involvement in some form of settlement. At that time, the respective receivers for DBL and LACOP continued to disagree on a solution to their dispute as to which State had liability for those policies and they were in litigation over that issue.

In December of that year, the NAIC executive committee adopted a resolution urging NOLHGA and its members to take immediate action to satisfy contractual obligations to the owners of ValuBuilder Annuities. Meetings and negotiations continued through most of 1991 and a settlement agreement was sent to the guaranty associations on October 31, 1991. The terms of the settlement are in our written statement and I won't go into that.

I'm running short on time so I'll summarize by saying that this was, by any measure, an extraordinary situation and one that we hope will not be repeated. The bad news is that policyholders had to wait far too long for resolution of the issues, holding up access to their funds. The good news is that the guaranty associations were able to come up with a settlement that ultimately resulted in all policyholders receiving the money, including interest, to which they were entitled. In fact, as part of the settlement SBL paid for

the contract account values in excess of the guaranty associations benefit limits.

In other words, as Senator Thurmond noted, the guaranty associations were confronted with a very difficult situation where policyholders were not being paid, and they came together and effected a solution to avoid the delays of further litigation.

I thank you, Mr. Chairman.

[The prepared statement of Mr. Blaine follows:]

PREPARED STATEMENT OF JACK H. BLAINE, ON BEHALF OF THE NATIONAL ORGANIZATION OF LIFE AND HEALTH INSURANCE GUARANTY ASSOCIATIONS (NOLHGA)

Mr. Chairman, members of the Subcommittee on Antitrust, Monopolies and Business Rights, my name is Jack H. Blaine and I am president of the National Organization of Life and Health Insurance Guaranty Associations (NOLHGA). NOLHGA is a voluntary association of the 50 state life and health insurance guaranty associations, as well as those serving the District of Columbia and Puerto Rico. NOLHGA works with rehabilitators and liquidators to facilitate meeting the statutory obligations of the various state guaranty associations. Later in this statement we will discuss how NOLHGA functions in dealing with multi-state insolvencies.

I appear here today at the invitation of the Subcommittee to discuss the global settlement entered into between several state guaranty associations, Security Benefit Life Insurance Company, and the receivers for two insolvent life insurance companies to provide a resolution of a problem encountered by owners of "ValuBuilder Annuities." Before discussing that settlement, however, it might be useful to the Subcommittee to have a brief summary of the state life and health insurance insolvency system in place today, with a reference to the status of relevant state laws at the time the ValuBuilder Annuities block of business became the subject of the settlement.

OVERVIEW OF STATE GUARANTY ASSOCIATION STRUCTURE

As alluded to earlier, all states, the District of Columbia and Puerto Rico have enacted legislation based on the current or earlier versions of the NAIC Model Life and Health Insurance Guaranty Association Act. That Act [1] has as its purpose the protection of persons who are beneficiaries, owners, assignees or payees of direct, non-group life, health, annuity and supplemental policies or contracts, for certificates under direct group policies and contracts, and for unallocated annuity contracts [2] issued by insurance companies who are members of the state guaranty association, subject to certain limitations and exceptions. Membership in each state guaranty association is required of all insurers licensed in the enacting state to write the covered lines of business.

Presently, state guaranty associations are governed by a five- to nine-member board of directors selected by member insurers, subject to approval by the state's insurance commissioner, who, of course, is an appointed or elected state official. Members of the boards serve without compensation but are entitled to reimbursement of expenses. I should note that at its June 1993 meeting concluded just last week, the Guaranty Fund Task Force of the National Association of Insurance Commissioners approved an amendment to the Model Act to provide for the inclusion of two public representatives on guaranty boards. The association must submit annual reports to the commissioner. In addition to other powers and duties, the commissioner may assume the powers and duties under the act when the association fails to take action with regard to an impaired or insolvent insurer within a reasonable time.

When a "member insurer" is declared by a court to be financially impaired or insolvent, the association may be activated and called upon to provide protection for policyholders and beneficiaries. Claims against the insolvent insurer are covered up to specified maximums, usually $300,000 in death benefits, $100,000 in cash value life insurance, $100,000 in health insurance benefits and $100,000 in the present value of annuities, with an aggregate of $300,000 in benefits for all accounts. Those

[1] For purpose of this statement references are to Model Act provisions which are common to virtually all states except as otherwise noted.

[2] This statement does not dwell on the subject of coverage of unallocated annuities; however, it should be noted that only 19 states specifically cover such contracts, and two other states do so by court interpretation. Unallocated annuities includes guaranteed interest contracts and group deposit administration contracts.

states that cover unallocated annuities pursuant to the current Model Act provision do so on a per contractholder, or per contract, basis of $1 million, $2 million or $5 million. The Model Act requires that the guaranty association continue coverage in force consistent with the rights of the policyholder. This obligation to continue life insurance, health insurance and annuities in force is perhaps the major distinction between this insolvency protection system and ones for property-liability insurance, or for depositors of banks on other financial institutions.

To provide the funds needed to fulfill the obligation to covered policyholders, the act provides for assessments against member insurers in proportion to each of their respective shares of the premiums written in the state on the covered policies and contracts. The act sets up accounts for life insurance and annuities, and for health insurance, for purposes of administration and assessments.

The current (1987) version of the NAIC Model Act provides that the guaranty association must provide protection for residents of its state, regardless of the domicile of the insolvent member insurer.[3] This was a major change in the Model Act from prior versions and the difference is very relevant to a discussion of the ValuBuilder Annuity case. Under a prior version of the Model Act, which was in effect in most states until the last few years, the state of domicile of the insolvent insurer was responsible for protecting all of the policyholders of the insolvent insurer, wherever they resided. Only five states still have this earlier version of the Model Act; all other jurisdictions today have the "residents only" version of coverage, including Pennsylvania and Arizona.

HOW NOLHGA OPERATED

For purposes of dealing with multi-state insolvencies, NOLHGA's by-laws established a Disposition Committee over three years ago with responsibility to review and approve all assumption reinsurance agreements, claims servicing agreements and other contracts dealing with the disposition of policies of insolvent insurers. That Committee has nine appointed members, all of whom are administrators of state guaranty associations. In addition, any association that is affected by the insolvency that is not represented by an appointed member or ex officio member may have an ad hoc representative at the Disposition Committee meetings.

Inherent in the Committee structure are task forces formed for each multi-state insolvency that are intimately involved in working with receivers to develop a plan for serving the failed company's policyholders. Task forces are comprised of a representative of the guaranty association in the state of domicile of each insolvent company, plus the three member associations which have the highest amount of policyholder obligations. The task force is usually chaired by a representative from a state with minimal liabilities and has other members representing states with the three or four largest liabilities. Consultants are retained to assist in the process. Since its formation, this process has been at work in a number of multi-state insolvencies, the sizes of which range widely.

This task force process was not yet formally in place at the time of the ValuBuilder Annuity case and its settlement. Today, the insolvencies of Diamond Benefits Life Insurance Company (DBL) and Life Assurance Company of Pennsylvania (LACOP) would have called for the appointment of task forces and, given the changes in state laws since then, the current process would have been followed. At the time LACOP and DBL became insolvent, their states of domicile, Pennsylvania and Arizona, respectively, covered all the policyholders and beneficiaries wherever they resided. If either of those states had been clearly liable for the ValuBuilder annuities, other states' guaranty associations would not have been activated. If neither Pennsylvania nor Arizona was responsible for covering the policyholders resident in other states, the other state guaranty associations would protect their respective resident annuity owners. Whether the disputes over which insolvent insurer, or Security Benefit Life (SBL), had responsibility for the policyholder liabilities would have been avoided is unclear. It is probably safe to say, however, that resolution of the problem would have come much quicker.

THE VALUBUILDER ANNUITY CASE

The history of the ValuBuilder annuities has already been made a matter of record before this Subcommittee in the testimony of Mr. Howard R. Fricke, President of Security Benefit Life Insurance Company (SBL), on May 5, 1992. In sum-

[3] The Model Act provides that the state guaranty association of the state of domicile of the insolvent insurer will cover residents of other states if the insolvent insurer was not licensed in that other state, subject to certain conditions.

mary, the controversy concerns a block of annuity contracts that was first acquired in the early 1980's by SBL from First Pyramid Life Insurance Company, Little Rock, Arkansas. The block was subsequently sold by SBL to LACOP in 1987; in 1988 LACOP transferred the contracts to DBL. Both LACOP and DBL were later taken over by their respective domestic state insurance regulators, and both state receivers took the position that the other had liability for the annuities.

NOLHGA did not become officially involved until December 1990, although there had been informal contacts and discussions with NOLHGA staff beginning in the summer of 1990 regarding possible involvement in some form of settlement.[4] At that time the respective receivers for DBL and LACOP were unable to agree on a solution to their dispute as to which estate had liabilities for this block of annuities and were in litigation over the issue. The NOLHGA Board of Directors, at its meeting in August 1990, encouraged the NOLHGA President and the Disposition Committee to attempt to bring the disputing parties together in an effort to effect a settlement. In its meeting on December 5, 1990, the NAIC Executive Committee adopted a resolution urging NOLHGA and its members to take immediate action to satisfy contractual obligations to the owners of ValuBuilder Annuities. A meeting was called on December 20, under the auspices of NOLHGA, of guaranty association representatives from the eight states with the largest amount of policyholder liabilities. Negotiations with counsel for SBL commenced about this time and resulted in agreement on a Settlement Proposal which, on June 7, 1991, was sent to member guaranty associations with potential policyholder liabilities. The terms of the settlement proposal were essentially as follows:

- Except for one large annuity,[5] SBL would assume liability for all of the ValuBuilder annuities;
- There would be no reduction in account values (the amount due the contract owner, which includes the initial consideration plus interest minus any withdrawals);
- SBL agreed to cover the account values in excess of the benefit limits of state guaranty associations;
- SBL agreed to contribute $1 million in cash and a note in the amount of $500,000 which would be paid one year after closure, provided that SBL maintains an A+ rating;
- The Arizona Guaranty Fund, the Pennsylvania Guaranty Association and the other participating guaranty associations would be responsible for one-third of the aggregate guaranty fund cash value benefits, less $1 million;
- Provision was made for a subrogation of rights by the contributing guaranty associations against the estates of DBL and LACOP, subject to a reduction of 50 percent of the amounts contributed to the settlement and waiver of claims for administrative expenses; and
- There was also provision for sharing in any recovery from litigation against third parties, on a pro rata basis.

MECHANICS

During the period from June 7, 1991, through September 1991, NOLHGA worked with the various guaranty associations in responding to questions and issues regarding the proposed settlement. NOLHGA also developed a detailed Participation Agreement that was sent to the participating parties on October 30, 1991. A slightly revised version of the Agreement was sent in January, 1992, that accommodated a belated request by the DBL receiver for amendments of a nature that would not impact adversely on the participating parties. It should be noted that, beginning in the spring of 1991, NOLHGA staff and its members were heavily involved in addressing the failure of Executive Life Insurance Company (California) and a number of other financially impaired large and small insurers.

Between November 1991 and March 1992, while the participating guaranty associations were taking action on the Participation Agreement and related documents, the Arizona and Pennsylvania liquidation courts reviewed and approved the Plan, a condition for going forward. Concurrently, SBL was working on identifying present policy values. Because SBL already had been sent the policy files by the Arizona receiver, SBL was asked to undertake the task of listing the values by state and

[4] The ValuBuilder Annuities are single premium deferred annuities and would be covered under the state guaranty association laws of all states if the insurer failed today, typically subject to a benefit limit of $100,000.

[5] Frequently referred to as the Hansen annuity, this contract was owned by the Resolution Trust Corporation as an asset acquired from an insolvent savings & loan association.

performing the calculation of financial contributions by the guaranty associations, using the formula in Section 5.1 of the Agreement. A settlement trust was established pursuant to the Agreement to receive the contributions from the guaranty associations and to disburse the funds to SBL. All contributions were sent from the associations prior to the May 12, 1992 deadline. The aggregate amount of the contributions from the associations was $22,236,299.34.

The closing on the Participation Agreement was thereafter delayed from June 1992 to November 1992 because of class action litigation in Arkansas against SBL. However, pursuant to an agreement between NOLHGA and SBL, the effective date of the assumption of the ValuBuilder annuities was set at May 15, 1992.

In March 1992, SBL had sent a communication package to the ValuBuilder annuity owners informing them of the Participation Agreement with the guaranty associations, describing the class action suit against SBL pending in an Arkansas circuit court, and asking for releases from claims against SBL, DBL, LACOP and any applicable guaranty association in exchange for SBL's assumption of their annuity or honoring a previously-submitted surrender application. In April 1992, an Arkansas circuit court judge decertified the class reportedly for the reason that the benefits under the Participation Agreement were at least equal to or superior to that which the policyholders would receive if they pursue claims against one or another of SBL or a guaranty association. However, counsel for the policyholder class later appealed the case to the Arkansas Supreme Court which stayed SBL from further communication with policyholders until such time as they were able to rule on the case. The appeal was dismissed when SBL reached a settlement with the class' counsel that received lower court approval October 27, 1992. This finally allowed SBL to proceed to closure on the Participation Agreement.

Closure took place on November 30, 1992, when the trust disbursed the funds to SBL to cover the annuitants who had signed releases. (The transactions relative to the Trust are subject to final audit.)

AUTHORITY

Included in the settlement by the guaranty associations was coverage of policyholders in states with no guaranty associations or no guaranty association coverage because neither DBL nor LACOP had ever been licensed there. During 1991, this provoked considerable discussion by various affected state guaranty association boards of directors who were legitimately concerned about exceeding statutory authority. Counsel for NOLHGA and individual associations were of the opinion that the boards could agree to this condition as part of an overall settlement since liability was in legitimate dispute. The core of the settlement from the standpoint of the guaranty associations and NOLHGA was simply this: these policyholders were being left in limbo for a considerable time while litigation and controversy prolonged a resolution of their status; the issue of which insurer, and ultimately which guaranty association, was responsible was not clear and would have to be resolved through lengthy litigation or a settlement; and states other than Arizona and Pennsylvania were concerned about their residents being left unprotected for an unreasonably long period of time.

CONCLUSION

This case is by all standards an extraordinary one and hopefully will remain an isolated incident that will not be repeated. We believe this issue is behind us and the contract owners have finally received their annuity values, either in cash surrenders or with a continuation of benefits through SBL. That the annuity owners had to wait too long for resolution of this complex situation is not in dispute. From the beginning, NOLHGA's overriding concern was to effect a solution in the best interest of the annuity owners. That goal was achieved.

The insurance regulators have imposed increasingly more stringent rules on assumption reinsurance transactions; and last week the NAIC approved a Model Assumption Reinsurance Act to further strengthen regulation to protect policyholders. With residents-only coverage by state guaranty associations having been enacted by most states, one major obstacle encountered in this dispute has been removed. Furthermore, all states now have an insolvency guaranty mechanism, a situation that did not exist in 1990. We believe that if a similar situation occurred today involving an assumption reinsurance transaction, it would be resolved much more quickly and efficiently.

Senator METZENBAUM. Thank you very much, Mr. Blaine. I do have some questions, as you might have anticipated.

Staff suggests that we go forward and let each of the witnesses speak before we get into questions. Mr. Simmons, why don't you proceed with your statement, please?

STATEMENT OF DAVID SIMMONS

Mr. SIMMONS. Thank you, sir. Good morning, Mr. Chairman, Senator Thurmond. I'm David Simmons, executive vice president of the National Association of Insurance Commissioners, the NAIC. The NAIC is the oldest organization of State officials consisting of insurance regulators from the 50 States, the District of Columbia, and the territories. It was formed to assist State insurance regulators in protecting consumers and policyholders, and that continues to be our primary purpose.

Today I'll discuss two issues, the NAIC's efforts to protect consumers caught in the insolvency of Diamond Benefit Life Insurance Co. and the NAIC's initiatives to improve the guaranty fund system.

Let me begin by briefly mentioning the NAIC's work on guaranty funds. As you know, State regulators have expressed concerns about gaps in guaranty fund coverage, the governancy of guaranty funds, the lack of consistency of guaranty fund coverage among the States, and problems of coordination of the funds with receivers and liquidators. The NAIC has been working diligently on these issues.

Under the NAIC's financial regulation standards accreditation program, each State must have a guaranty fund in place for both property, casualty, and life, and health insurers. Since 1989, the adoption of the standards, few States that did not already have them have created such funds, so we do have 50 State coverage today.

Last week the NAIC added to the program the requirement that each State have specific provisions of the NAIC model dealing with coverage by life and health guaranty funds of residents and nonresidents. The effect of that language in the NAIC model is to close gaps in coverage that might arise between States that do not have the model act provisions. Therefore, States seeking to gain or retain accreditation by the NAIC will have to have the NAIC's language on this subject on their books.

The NAIC has also taken steps to increase consumer involvement in the operation of guaranty funds. Last week, the task force voted to amend the NAIC model laws on guaranty funds to require consumer representation on the boards of the guaranty associations. This issue likely will be addressed by the full NAIC by the end of the year.

Finally, on a broader level, the NAIC has been expanding, examining a full array of options to improve the overall coverage and coordination of guaranty funds. The issues we're considering include the use of the accreditation program to increase uniformity, the viability of interstate compacts as a coordinating mechanism, and the establishment of a national database on rehabilitations and liquidations. I expect that that task force will make its recommendations by the end of 1993.

Now turning to the Diamond Benefit insolvency, prior to becoming executive vice president of the NAIC I served as general coun-

sel to the NAIC for 4 years. Before that I was chief counsel and assistant insurance commissioner in the State of Arkansas. From the previous two positions I acquired some familiarity with the ValuBuilder Annuities originally marketed by First Pyramid Life, an Arkansan insurer, and subsequent problems that were encountered by the holders of those annuities.

A little background here might be helpful to you. First Pyramid Life existed as a small, stable insurance company until the last 1970's and early 1980's. In those years it responded, however, to the high interest products being offered by banks and savings and loans by greatly expanding their writings of volatile, interest-sensitive annuity business. By 1984 it was increasingly stressed financially and it was under the close supervision of the Arkansas Insurance Department. Now it's important to note that Arkansas at that time did not have a guaranty association to protect policyholders.

Security Benefit Life Insurance Co., an A-rated company, surfaced as a buyer and it was with a great sigh of relief from myself and other regulators that they acquired First Pyramid Life. The First Pyramid policyholders were saved at that time.

By 1986, however, Security Benefit apparently felt that it could no longer prop up First Pyramid and began to look for a purchaser of that company and of its business. After several months and extensive negotiation, various blocks of First Pyramid contracts were sold, under the insurance department's close scrutiny, to other insurers of a more stable posture. Security Benefit itself, by assumption reinsurance contract, assumed responsibility for the ValuBuilder Annuities, a transaction that was very favorable to those policyholders that had the ValuBuilders.

Unfortunately, you know the luck of those annuitants didn't hold out. Security Benefit subsequently transferred the business to Life Assurance Co. of Pennsylvania, which further transferred it to Diamond Benefit Life in Arizona. Diamond Benefit was placed in receivership proceedings within 6 months of their acquisition, and while litigation over that transaction was pending the receiver for Diamond Benefit and LACOP, LACOP also went into liquidation.

In the fall 1990, the NAIC was contacted by an attorney from Security Benefit Life and informed of the fate of those policyholders and of the fact that their business has not been serviced in over 2 years because of this litigation between Diamond Benefit's receiver and LACOP. Security Benefit had also apparently been sued by policyholders at that time.

The NAIC responded by quickly forming an ad hoc subgroup consisting of the insurance commissioners of the States most directly affected to study the problem and attempt to get annuitants made whole very quickly. After the facts of the litigation became known it was apparent that a resolution of the litigation was going to take many years. This was unacceptable to the membership of the NAIC. In an attempt to pressure the various parties into arriving at some solution that would enable policyholders to be paid before years of litigation was resolved, the membership passed a resolution in December 1990 calling for a plan to be in effect by January 1991.

Now due to the subsequent receivership of LACOP and American Universal as well as the complexity of securing the individual guar-

anty funds' approval in class action lawsuits that were pending and appealed, there was a substantial delay. I have no doubt, however, that the pressure applied by the NAIC resulted in a resolution of this matter to the policyholders' benefit long before it would have been resolved had the litigation been permitted to run its final course. To that extent, the NAIC satisfied the purpose of protection of policyholders.

The experience of this case was also important to the NAIC's determination to take action in two other areas. One, to develop a model law governing assumption reinsurance, and also development of more coordination of receiverships and guaranty associations. Both of those subjects are under active consideration at the present and by fall, as I said, we hope to see substantial new protections for consumers.

I'm sorry that the timing of the hearing did not permit me to prepare a more detailed written response, but I will be happy to supplement my testimony with written material, if you desire, and I'm pleased to take your questions.

Senator METZENBAUM. We'd be very happy to have you supplement your remarks and they will be included in the record. Thank you very much.

Mr. Dummer.

STATEMENT OF ARTHUR O. DUMMER

Mr. DUMMER. Thank you, Mr. Chairman and Senator Thurmond. My name is Arthur Dummer. I'm managing secretary of the Utah Life and Disability Insurance Guaranty Association, in which capacity I am appearing today. It's an honor for me to be here and to respond to the invitation to provide some comments on the public accountability of the guaranty association system, a system with which I have been closely involved for most of the past 20 years. I was one of the founding directors of NOLHGA and served as its chairman in 1984 and 1985. I have also been the chairman of the task forces on the three largest insolvencies with which the State guaranty association has dealt over the past 10 or 15 years.

After a hiatus from 1986 to about 1990 at which time I was away from the guaranty association system, in late 1989 I contracted to provide administrative services as the managing secretary of the Utah Life and Disability Insurance Guaranty Association system. So I'm here today really as a person who has been intimately involved in fashioning national responses to major multi-State insolvencies and as a person who is involved in the day-to-day operations of an affected association.

I think the public accountability of this system can be approached from two orientations. First, what is its accountability to the public as people who depend on insurance for their security. There's another accountability, as you have indicated, Mr. Chairman. That is, what is the accountability of the system to the public as people who foot the bill for the insolvent companies, either through reductions in their dividends or other increases in the cost of their insurance, or through the premium tax offset provisions in many States.

In Utah, and in most other States, the public accountability of the guaranty association to Utah citizens is expressed through its

relationship with the insurance commissioner. The insurance commissioner in any insolvency represents the policyholders, and the insurance commissioner is also authorized to assume the powers of the association if the association fails to meet its statutory obligations in a timely manner. In Utah, the insurance commissioner regularly attends association board meetings and generally provides input, occasionally exercises approval in connection with the board's decisions. This is particularly true where it is not always clear what the statutory standards are.

On a national level, during the courses of the Executive Life and Mutual Benefit matters over the last 2 years I've had the opportunity to meet with the boards of various State associations and I've observed time and time again that there's a high level of sensitivity to the needs of the victims of insolvencies, notwithstanding what you might think would be the members natural tendencies to prudently manage the association's assessment resources and be parsimonious about the provision of benefits to policyholders.

Turning to the system's public accountability for its indirect expenditures of public funds through the operation of premium tax offsets in many States, I am struck with the alignment of the interests of board members with the interests of public in this regard.

It has been asserted on occasion that the boards of the individual guaranty associations may on occasion disregard the cost of their decisions because of the premium tax offset provisions. In my view, this assertion is absurd. I have spent hundreds of hours in board meetings and in working committees of the associations and I have never once heard any suggestion or hint of such a proclivity.

In fact, quite the opposite attitude prevails and there are at least three good reasons for that. First, there are several very important States in which there is no premium tax offset or where the offset is so limited as to be irrelevant. Second, even in States which have offsets, the assessments can only be recovered over several years without interest. The effect is that all insurance companies have steadily increasing assessment recoverables which represent major, non-interest bearing assets. This cost is real and it's not insignificant.

Finally, the representatives of the companies who sit on the boards have been conditioned through years to pay only legitimate claims. Thus, in my view, there would seem to be little reason to believe that the association's sensitivities to the cost of insolvencies are diminished because of premium tax offset provisions.

I would like to comment briefly on the degree of independence from industry control the guaranty association system enjoys. The system is not without its conflicts of interest. There are at least four identifiable constituencies with somewhat compete interests. These are the insured public, the regulator, the member companies, and the premium-paying or taxpaying public. There is a high level of congruence between the insured public and the taxpaying public.

To finish on time, I'd like just to mention that the State life and health guaranty association system is relatively young in age and relatively young in experience. Recent years have seen a marked increase in the number and complexities of insolvencies, but I think by keeping the system's roots local, its accountabilities local,

and its operations simple and unbureaucratic, the system has responded quite well.

Thank you for the opportunity to be here today.

[The prepared statement of Mr. Dummer follows:]

Prepared Statement of Arthur O. Dummer on Behalf of the Utah Life and Disability Insurance Guaranty Association

PUBLIC ACCOUNTABILITY OF THE STATE GUARANTY ASSOCIATION SYSTEM

It is an honor for me to respond to the invitation to appear before this committee to provide comments on the public accountability of the state insurance guaranty association system.

I have been closely involved with this system for most of the past 20 years. As the first Chairman of the Utah Life and Health Insurance Guaranty Association which was established in the mid-1970s, I was one of the organizing directors of the National Organization of Life and Health Guaranty Associations ("NOLHGA"). I served as Chairman of the Board of NOLHGA in 1984–5 and a member of its Executive Committee from about 1983 through 1986.

I was also chairman of the task forces that have dealt with the guaranty associations' responses to the three largest insolvencies of life and health insurance companies: Baldwin-United insurance affiliates in the early 1980s, Executive Life Insurance Company of Los Angeles, California in 1991–3 and Mutual Benefit Life Insurance Company of Newark, New Jersey in 1992–3. I was not involved with the guaranty associations from 1986 till late 1989 when I contracted to provide administrative services as the Managing Secretary of the Utah Life and Disability Insurance Guaranty Association.

These experiences have afforded me an opportunity to become well acquainted with the operations of the state guaranty associations system and my perspective here today is both of a person who has been intimately involved in fashioning national responses to major multi-state insolvencies and of a person who is involved in the day to day operations of a small affected association.

The public accountability of the system can be approached from two orientations. First, what is its accountability to the public as people who depend upon insurance for their security? Second, what is its accountability to the public as people who foot the bill through reductions in dividends or other increases in the costs of their insurance policies and through the premium tax offset provisions in many states?

As a creature of statute, the Utah association's accountability to Utah citizens as beneficiaries or potential beneficiaries of the association's powers and obligations is formally expressed through its relationship with the Insurance Commissioner of the State of Utah. In any insolvency, the Insurance Commissioner as receiver of the insolvent company is also charged with representing the interests of the insolvent company's policyholders. The Commissioner is authorized to assume the powers of the Board of Directors of the association if the association fails to meet its statutory obligations in a timely manner.

The Insurance Commissioner is invited to the association's board meetings, and generally provides input and occasionally exercises approval in connection with the board's decisions. The Commissioner is advised of and/or consulted on all major decisions.

The association is directly accountable to the insured public through the operation of an office that is staffed during all normal business hours with personnel knowledgeable about the association's duties and powers. This office, which maintains a close liaison with the Insurance Department, fields many referrals and inquiries and provides appropriate services to policyholders affected by insolvencies. When an insolvency occurs, the association's phone number and mailing address are usually communicated to resident policyholders of the insolvent company.

On a national level, during the courses of the Executive Life and Mutual Benefit Life matters over the last two years, I have had the opportunity to meet with the boards of various state associations. I have observed time and time again that there is a high level of sensitivity to the needs of the victims of insolvencies, notwithstanding the board members' natural tendencies to prudently manage the associations' assessment resources.

Turning to the system's public accountability for its indirect expenditures of public funds through the operations of premium tax offsets in many states, one is struck with the alignment of the interests of board members with the interests of the public in this regard.

It has been asserted that the boards of individual guaranty associations may on occasion disregard the costs of their decisions because of premium tax offset provisions. This is absurd. I have spent hundreds of hours in board meetings and in working committees of the associations and have never heard any suggestion or hint of such a proclivity.

In fact, quite the opposite attitude prevails. There are at least three good reasons for that. First, there are several important states in which there is no premium tax offset, or the offset is so limited as to be irrelevant. Second, even in states which have the offset, the assessments can only be recovered over several years, without interest. The effect is that all companies have steadily increasing assessment recoverables which represent a major non-interest bearing asset. The cost is real, and not insignificant.

Finally, the representatives of companies which serve on the boards of the individual associations are people with broad experience and understanding of the insurance business and they are conditioned through those experiences to pay only legitimate claims.

Thus, there would seem to be little reason to believe that the associations' sensitivities to the costs of insolvencies are diminished because of premium tax offset provisions.

A somewhat related case study is the premium tax offset treatment of the voluntary contributions of a group of 50 major companies for the Baldwin United insurance companies' insolvencies. The Utah association, and I believe most other associations, afforded these companies an offset only to the extent of what their assessment would have been without the voluntary contribution. Some companies contributed more than their share in Utah. They did not get premium tax offsets for the excess.

That is not to say that the premium tax offset provisions are not important to the members and board members of the associations. Indeed they are highly valued for their moderating effects on the demands of insurance supervisory officials. It is probably not a simple coincidence that there is a high degree of correlation between the absence of a premium tax offset provision and an insurance commission that takes the most liberal views of the associations' obligations.

I would like to comment briefly on the degree of independence from "industry" control the guaranty association system enjoys. The system is not without conflicts of interest. There are at least four identifiable constituencies with somewhat competing interests. These are (1) the insured public, (2) the regulators, individually and collectively, (3) the member companies, and (4) the premium paying and/or tax paying public who pay the costs.

Guaranty association boards are aware of the need to balance these competing interests. The enabling acts creating them represent their charters and define the limits of their acts. Most acts contain language to the effect that the act should be construed liberally to effect the purpose of protecting the insured public from the failure of insurance companies. That has generally been the result.

The structure of the Utah association and most other associations is such that local (and therefore usually smaller) companies tend to represent the majority of the board members. For political as well as practical reasons, these local companies constitute the executive committee. Thus it is a practical impossibility for one major company, or even a number of major companies to dictate decisions through their representatives.

To be sure, major companies and associations of major companies have a degree of influence. But the degree of influence is probably less than their market shares, a reality with which they are probably not particularly happy.

With respect to specific insolvencies, the mechanism that the sovereign associations have developed to act collectively is the formation of solvency specific committees consisting of representatives of those associations having the greatest exposure to loss. Members of these committees and their task forces are not employees or independent contractors of NOLHGA. These committees make all major policy decisions for the specific insolvency for which they are established. They are very independent and reflect the interests of the affected associations, as those interests are interpreted and supervised locally.

The notion of a monolithic "Industry" control of the guaranty association system is a myth.

Perhaps in response to the competing constituencies, there have been calls for greater public representation on the boards of the associations. This may develop into a trend, which the insurance companies will probably view with some misgivings. If it does, there is no reason to assume that the public officials will select people to serve on the boards who are not capable, high quality, responsible people.

Indeed, that has certainly been the case in Texas, the one state of which I am aware where this has occurred.

The state life and health insurance guaranty association system is relatively young in age and experience. For most of its 20 odd years of existence, the challenges have been few. Recent years have seen a marked increase in the number and complexities of insolvencies. By keeping its roots local, its accountabilities local and its operations simple and unbureaucratic, the system has responded quite well.

Improvements can and will be made. Standards practices and protocols will become better defined as the system continues to successfully meet its challenges. As the system matures, its constituents: the public, the industry and the regulators will help forge the kind of system they want.

Thank you for the opportunity to attempt to provide some illumination on this admittedly obscure system. I believe that it is doing a good job of balancing its competing public accountabilities. I hope that these comments will prove useful and informative to your deliberations.

Senator METZENBAUM. Thank you very much, Mr. Dummer. I might say just parenthetically that when you talk about how there's four different groups and the guaranty fund boards, let me say that here's a chart that indicates 98 percent of the people on those boards represent the industry. Now they may have different aspects, different positions with respect to the industry, but the fact is 98 percent represent industry and only 2 percent for the public. I think it's pretty hard for the public to believe that their interests are being served and concerned about.

So part of one of the issues we're talking about today is the fact of, the reality of the insurance companies using the guaranty funds and the tax offsets to subsidize what was otherwise their responsibility. We'll get to that as we proceed along, but I just wanted to make that clear.

We will have 10-minute rounds, Senator Thurmond, is that's agreeable with you.

Mr. Blaine, I know all of that which transpired in connection with NOLHGA's activity as pertains to Security Benefit Life came about prior to the time you became the president of NOLHGA; is that correct?

Mr. BLAINE. That's correct, Mr. Chairman. I joined NOLHGA in February 1992 and the transaction was pretty largely completed by then.

Senator METZENBAUM. In December or January 1992?

Mr. BLAINE. I believe it was February 1992.

Senator METZENBAUM. The American people have been misled by the insurance industry into believing that insurance companies finance the guaranty funds. The reality is that's just not true. Maybe not a total lie, but a 79-percent lie at least, because for every dollar that insurance companies put into the guaranty funds they write off 79 cents against their State taxes. Do you disagree with that statement?

Mr. BLAINE. I fear I must disagree, Mr. Chairman. I think the 79-percent figure assumes that all States have the same tax offset provision, and that is simply not true. As Mr. Dummer said, there's some large important States—California, for example, which represents 14 percent of the national market for life and health insurance has no tax offset.

Senator METZENBAUM. That figure does not assume that, Mr. Blaine. We're going on the basis of the actual calculations. So you have a situation where the American people and insureds think

that they're somehow getting protected by these guaranty funds, which have limited liability, but at least they're guaranty funds.

Then we find that almost 80 percent of the total is being subsidized by taxpayers, many of whom don't have a damn thing to do with the insurance industry, don't have any insurance policies. They are just ordinary taxpayers but they're being hit because the insurance industry has been able to conceptualize this matter and put it into effect in such a way that it places ⅘ of the burden on the average taxpayer.

The 79 percent was from a study by two insurance professors who testified at our last hearing and their testimony, I'm sure, you've even seen or you're certainly welcome to see it.

Mr. BLAINE. I'm very familiar with the study, Mr. Chairman. I was at that hearing and I read the paper. Unfortunately, or fortunately, the paper was based on years prior to 1992, and California had no guaranty fund until 1991. So my recollection is, that study used years where California was not a factor as far as the tax offset and assessments were concerned.

In other words, if the study were done using more current years, that percentage would drop. In fact, this year the State of Washington repealed its tax offset. There is no guaranty that a State will not repeal the tax offset, Mr. Chairman.

Senator METZENBAUM. I understand that. But the point is, now we're sort of quibbling as to whether its 79 percent or something a little less because of California having a State insurance fund. But the fact is that the taxpayers of the respective States are carrying the burden of the insurance guaranty funds, whether it's 79 percent or 75 percent or 72 percent. That's the thing that I find so difficult to comprehend, and my guess is that 99.99999 percent of the American people would have difficulty in understanding that.

Mr. BLAINE. May I respond, Mr. Chairman? With all due respect, I suspect that the policyholder of an insolvent company really doesn't care whether the funds that pay them off come from insurance companies with a tax offset or not. One way or the other, the public will pay for it. If it's not through a tax offset, as it is in some States, it will be through a reduction in dividends or an increase in premium. The companies can't pay the assessments out of thin air, Mr. Chairman. They pay it out of earnings.

Senator METZENBAUM. Now I'm incredulous. Now you're saying the insured doesn't care. I totally agree with that. The insured wants to get his or her money.

Mr. BLAINE. Absolutely.

Senator METZENBAUM. But the question is, who's going to pay it? So you're saying, one way or the other the public is going to pay it. I never knew that there was any law—I came out of the business to the U.S. Senate. I never knew there was any law that said you couldn't take it out of the profits or the potential dividends of the company, or the executive salaries of the company. That's the real issue, who's the sucker? Is it the taxpayer of this country who's required to pay for insurance company misdeeds or errors, or is it going to be the insurance companies who are parties to it?

Now we're talking about a case today—and I should proceed forward—about Security Benefit Life, because in this case the taxpayers, to a very substantial extent, wound up paying the bill while

Security Benefit Life, a very solid, financially strong insurance company, didn't meet their obligation, and you in the industry failed to call upon it to do it.

In fact, your organization, NOLHGA, played a central role in developing the Security Benefit settlement. Under the settlement Security Benefit put up $7 million and 39 State guaranty funds put up $23 million—over three times as much. The funds also agreed to waive any right to sue Security Benefit to recover the $23 million.

The guaranty funds acted properly in taking care of the 3,000 annuitants. No argument about that. The problem I have with the settlement is the guaranty funds, at NOLHGA's urging, spent the taxpayer's money, but never determined that Security Benefit Life was not liable, and there was plenty of evidence that Security Benefit was liable.

As you know, in 1989 the Arizona Guaranty Fund took the position in court that the annuities had not been legally transferred to the Arizona company, and therefore, the Arizona company was not liable; the Arizona company being the transferee. Also in 1989, an annuitant won a default judgment against Security Benefit. In 1990, the company settled lawsuits by several individual annuitants, and the other annuitants began a class action lawsuit against Security Benefit.

Nevertheless, in 1991, NOLHGA recommended that the 39 guaranty funds waive their right to sue Security Benefit. If it had been their own money, if it had been the insurance companies' own money that was going to be used to bail out Security Benefit Life, I sincerely question, or seriously question whether they would have taken it. But they knew they were going to lay it off on the reduction in the taxes that the companies would have to pay.

In 1992, after the settlement was reached a Federal judge in Topeka found that Security Benefit Life was liable, at least to the largest annuitant. In view of the facts that Security Benefit was liable, I'm trying to understand why NOLHGA proposed a settlement that placed the burden on the taxpayers rather than on Security Benefit, which was a solvent and responsible party.

Based on records NOLHGA made available to the subcommittee—and we appreciate your cooperation—NOLHGA never, never, never got a written legal opinion that Security Benefit was not liable. Why didn't you get such an opinion?

Mr. BLAINE. I was not party to that decision, Mr. Chairman. But having gone through the file myself and read all the documents in it, it became pretty evident to me, as I'm sure it was to your staff, that the overriding goal of the guaranty associations acting through NOLHGA as an agent—and we did not do this independent of the guaranty associations.

But their overriding goal was to resolve this matter in the face of litigation between two receivers, Arizona and Pennsylvania, as to who had liability, and SBL, which was willing to defend any litigation against its being held liable, as it did in the case that you mentioned in the Kansas Federal District Court. The options that were laid out for the guaranty associations who were meeting to discuss a settlement were not very good, other than—they were not

very good in terms of reaching a quick conclusion of the problem except through a settlement.

And as I'm sure you know, in any settlement with a litigating party, you always get releases. Nobody is going to settle unless they're going to get a release and hold harmless from the other parties with whom they're settling.

Senator METZENBAUM. But Mr. Blaine, here's a company totally collectable. Security Benefit Life had assets—totally collectable. They wind up contributing $7 million to the settlement and the taxpayers of the various States wind up putting in $23 million. The courts are moving forward to hold Security Benefit Life liable, yet NOLHGA lets them off the hook.

According to NOLHGA records, your organization used Jeff Liebman of the law firm of Dewey, Ballentine to advise you on the Security Benefit settlement. Did NOLHGA get a written opinion from Mr. Liebman or any other lawyers at Dewey, Ballentine on Security Benefit's possibility liability? We asked for the NOLHGA documents, including all lawyer's documents and no legal document from Dewey, Ballentine was produced.

So I have trouble in understanding. You were not there, I'm aware. But I have trouble in understanding why NOLHGA stuck the taxpayers with a $23 million bill when there was a collectable insurance company who was liable—and no argument to the contrary that they weren't liable.

Mr. BLAINE. Mr. Chairman, first of all, for the record I must take exception to laying this off on the taxpayers. This decision, and everything I read in the file, there was nothing that would indicate that the tax offset was a consideration in reaching a settlement. All I saw was discussions as to whether the guaranty associations had the authority, whether they could go forward.

And in the discussions in those meetings, from the notes it is apparent that counsel was always present; that counsel provided advice and guidance to the participating guaranty association representatives. And I'm not aware that you need have a written opinion of counsel in order to be guided by their advice and counsel.

Senator METZENBAUM. Let me just tell you about Mr. Liebman and then I'll finish and turn the questioning over to my colleague. Mr. Liebman let the Pennsylvania Guaranty Fund's lawyers know that NOLHGA wasn't really very interested in Security Benefit's liability. Let me read from a memo prepared by the lawyer describing a conversation with Mr. Liebman.

> Liebman acknowledged that the NOLHGA proposal is a brokered document that deals more with political considerations and financial realities than with strictly legal analysis of the exposure of the various parties.

It appears that NOLHGA was less interested in who was liable for the annuities than in other considerations. Whether or not Security Benefit Life had friends at court or what the case was, I don't know. But all I know is that Security Benefit Life, a very collectable company, wasn't held responsible. The courts held it responsible subsequently. But wasn't held responsible by NOLHGA, but the money, the obligation was passed on, and you say it wasn't passed on to the taxpayers.

Mr. Blaine, I have to take issue with you. A hundred percent wasn't passed on, but 79 percent of the obligation was passed on

to the taxpayers by reason of tax credits that each of the insurance companies were permitted to have against their obligation to the various States leaving the constituents or the people who live in those States obligated to pick up the loss. They probably didn't know about it, but that's the reality.

Mr. BLAINE. Again, Mr. Chairman, the whole goal was to effect a settlement that would resolve these issues short of years of litigation. Again, I repeat that the considerations were largely focused on that goal. When you referred to Mr. Liebman's memo about financial considerations not being major—I don't know and can't read behind the literal words, but I'm sure he was referring to how the guaranty associations divvy up sharing this liability was less important than arriving at a conclusion, which is certainly understandable.

One other thing, Mr. Chairman. Much is made of the fact in your opening statement about Security Benefit Life being an A-plus best rated company, had some $50 million in surplus, I believe, at the time this happened. I think you should take into account the fact that Security Benefit Life—and I'm not here to defend that company by any means—but that company had already paid once for these annuities. They gave Life Assurance Co. of Pennsylvania $27 or $28 million in cash when they sold the business to them. Now you're suggesting that they should have paid again for that block of business.

Now this was a terrible situation and nobody can deny that. But I can't believe that a factor was not the fact, indeed, that Security Benefit Life had already paid for a block of business once and now to hold them liable for it again in the face of what was ordinary business practice at that time, it's a little bit inequitable.

Senator METZENBAUM. I just don't understand your thinking. Security Benefit Life made a business decision to lay off these 3,000 policyholders to—was it the Pennsylvania company?

Mr. BLAINE. Yes, LACOP.

Senator METZENBAUM. They gave them $27 million to take over the obligation. Now then, let's assume you and I, or let's assume you and General Motors have a contract. And General Motors doesn't want to live up to its contract with you. So they pay me $10 million to take over your liability. Does that discharge—and I'm not nearly as strong financially as General Motors is. Are you suggesting to me that General Motors still isn't liable to you when they assign the contract to me?

I mean, that's just not the law. If you did that, everybody in the whole world would be assigning their bad contracts to somebody else and sticking them with them, paying them something to take over this bad contract—I made a bad deal—if they could discharge themselves from their liability. That's what Security Benefit Life did, and unfortunately, NOLHGA, either out of stupidity, indifference, or irresponsibility permitted them to do it and stick the taxpayers with the bill. You seem to think that's perfectly OK. They made a bad business decision, so we insurance companies, other companies are coming in to bail them out and then we'll just pass on the bailout cost to the taxpayers. That doesn't seem to shock you at all.

Mr. BLAINE. I don't think, indeed, that the wrong thing was done in taking care of those policyholders, Mr. Chairman.

Senator METZENBAUM. I don't think it was wrong to take care of them. But I Security Benefit Life should have had to put up the money. Or, if you were so generous, let the insurance companies put it up themselves without taking a tax credit. But you took a tax credit. They all took a tax credit. That's the thing that's wrong.

Mr. BLAINE. I don't know as a matter of fact that they all took a tax credit. Not all States have a tax offset, Mr. Chairman.

Senator METZENBAUM. I guess where they couldn't get it they didn't take it.

Mr. BLAINE. No, sir, they did not.

Senator METZENBAUM. But that doesn't mean they didn't want to.

Senator Thurmond, do you have some questions?

Senator THURMOND. Just a few things, Mr. Chairman. Mr. Blaine, apart from the delay caused by litigation, do you view the resolution of the Security Benefit case as a success by NOLHGA and the system of State guaranty associations? And do you have any doubt that the global settlement of the Security Benefit case was in the best interest of the annuity holders and the overall system of guaranty associations?

Mr. BLAINE. No, sir, I have no doubt that the settlement effected was in the best interest of those policyholders. They received their money, plus interest. They received their money in excess of the normal limits on coverage of $100,000. In fact, the bottom line is, sir, they were made whole. And they were made whole at an earlier date than would have happened had there been continued litigation over this.

Senator THURMOND. Mr. Simmons, if you saw a significant problem of conflicts of interest among the board members of the guaranty associations would it be possible for the National Association of Insurance Commissioners to develop guidelines for when board members should rescue themselves from making decisions which would have a specific and direct impact on the insurer for which the member works?

Mr. SIMMONS. Yes, sir, that would not be a problem. I suspect that many of the individual associations have such a provision in their plan already. As you know, each State operates independently, but the boards have to submit a plan of operation to the commissioner for approval, and I suspect many of them have such a provision. But if that turned out to be a gap, we certainly would have no problem with that.

Actually, at the time this case arose we saw a potential for conflict from quite the opposite direction from which Senator Metzenbaum is coming in that we felt like that the guaranty associations would not want to jump in to settle this matter without more extensive and expensive litigation. That was more the conflict we were worried about and trying to avoid on that occasion.

Senator THURMOND. Mr. Simmons, there's been much discussion about the transfer of annuities by Security Benefit. Could you please explain the relationship between the insurers being able to transfer blocks of policies without excessive limitations and the willingness of insurers to enter new markets and product lines?

Mr. SIMMONS. Yes, sir, this is something our membership has struggled with basically over the past 2½ years. This case illustrated the need for some uniformity on rules on assumption reinsurance. The membership has gone back and forth over, even at times whether assumption reinsurance should be allowed as a business practice or just disallowed.

Some have argued, and quite persuasively at times, that total affirmative, positive consent ought to be required of 100 percent of the policyholders to allow an assumption contract to go forward. Now what that means in practical terms is that assumption reinsurance would be prohibited. So far, the majority of our members that have considered this issue—and we right now have just voted it up to a parent committee level, it has two more steps—do not feel like that would be in the best interest of policyholders.

You suggest, Senator, I think a primary consideration for that is assumption reinsurance allows companies to go off into areas that they hadn't traditionally written and to market policies. Then if they prove to be unwise business decisions for them, it allows them to sell off that block of business to someone else, allows new entry easier into the marketplace because they know they're not going to be stuck with a line that may be, in hindsight turned out to not be so wise to get in.

The same is true—business plans and procedures change with changes in company management, and the practice of assumption reinsurance allows companies to get out of lines and concentrate into other lines. So in my opinion, and at least the opinion of I think most observers, it does ease entry and exit from the marketplace.

Now certainly it's subject to some abuses at times. As I say, so far our membership has determined that the benefits to the consumers and the marketplace as a whole outweighs the abuse, if we take positive steps to correct those abuses, of just disallowing and prohibiting assumptive reinsurance.

Senator THURMOND. Mr. Dummer, I'll ask you and Mr. Blaine both this question. Would you like to comment on the importance to competition of insurers being able to transfer blocks of policies without excessive limitations?

Mr. DUMMER. I think Mr. Simmons has covered it adequately, Senator Thurmond. I've had a great deal of experience in brokering, if you will, these kinds of transfers and they do serve the business purposes of the insurance companies that are parties to these transactions. I do welcome, however, the attention that is being given this matter at the NAIC because some of these transactions have, in fact, been inappropriate. The subject case is a tragic example of that.

Senator THURMOND. Mr. Blaine, do you care to add anything further?

Mr. BLAINE. No, I believe Mr. Dummer has covered it very well, Senator.

Senator THURMOND. I'd like for each of you to answer this. We'll start with you, Mr. Blaine. Could each of you please address what you see as the benefits and the disadvantages of having consumer representatives sit on the boards of the guaranty associations.

Mr. BLAINE. I have given this some thought, Senator Thurmond, and it has been discussed over the last 2 years and I've been a party to some of those discussions. I think the advantage of having public representatives who bring a business sense to the board, I think is probably very good. I think that's a positive.

On the other hand, I think the negative is that many of the transactions are very complex and for persons not well acquainted with insurance matters, it may not be easy to understand and comprehend those decisions. I think those are the positives and the negatives. On balance, I suspect that having public representatives will bring something new to the boards that's desirable.

Senator THURMOND. If you had to choose, what position would you take?

Mr. BLAINE. I think I would be neutral, sir. I'm sorry. In response, I think I would favor public representatives if the selection process assures that they don't bring a prejudiced view to the system. If they come with a good business background or a sense of public concern, I think it would be fine.

Senator METZENBAUM. Senator Thurmond, I'm not clear whether your question and his answer refer to the State guaranty funds or to the NOLHGA boards?

Senator THURMOND. Would you care to explain that?

Mr. BLAINE. I was addressing membership on State boards. I'm sorry, were you asking me about NOLHGA's boards or State boards?

Senator METZENBAUM. NOLHGA is your organization, isn't it?

Mr. BLAINE. Yes, sir.

Senator METZENBAUM. What about yours? I don't mean to interrupt you, Senator.

Senator THURMOND. That's all right.

Senator METZENBAUM. What about your board? You have only 2-percent public representation.

Mr. BLAINE. On all of the State boards.

Senator METZENBAUM. You have none.

Mr. BLAINE. We have none, that's correct. We have nine members on our board of directors and, under the by-laws, they must be a member of a State board. Therefore, our membership, that is the NOLHGA board of directors membership is open to any member of a State guaranty association board. That would presumably include any public members of those boards.

Senator METZENBAUM. But there are none?

Mr. BLAINE. There are none currently, that's correct.

Senator THURMOND. Mr. Simmons?

Mr. SIMMONS. Yes, sir. I won't opine on NOLHGA's board. I haven't thought about that. I am of the opinion there is numerous benefits to having consumer representatives, public representatives on the boards of State insurance guaranty associations. We, I believe 2 years ago, adopted a new program at the NAIC, where we actually fund consumer representation to come to NAIC meetings. I think that we've benefited and the country has benefited from that practice. This is something I don't think you could discount the value of.

Now disadvantages, there certainly could be some, and that hinges—as Mr. Blaine said—I think on the selection process for the

board members. Conceivably, and this is an unusual setting and issue we're coming from. Working with guaranty associations in the past, the problem usually has been their reluctance to pay claims that should be paid. I can see that they should be prudent with the money, and that's accentuated when there's a tax offset.

But you certainly don't want payment of claims that aren't justified. I can see situations, if the selection process were wrong, where you could have attorneys who might themselves have conflict of interest serving on these boards, doing special deals. But that's the selection process.

I think overall the system would be improved by consumer representatives and I think this will go forward at the NAIC level.

Senator THURMOND. And you would favor that?

Mr. SIMMONS. Yes, sir, I would, personally. I don't get to vote, though.

Senator THURMOND. Mr. Dummer.

Mr. DUMMER. Thank you, Senator Thurmond. Over the last couple of years, I've had occasion to meet with the board of directors of the Texas association on two or three occasions. The Texas association has public representatives on its board. I think four out of nine.

I have found those public representatives at least equal, if not superior, to the representatives of the insurance companies that are on the board. They're outstanding people, and I see no reason to believe that the selection process on a State level to provide public representation on guaranty association boards wouldn't create the same result in most States, that they would in fact I think select qualified people.

I think your question is proper, however, to focus on the local State guaranty association systems, rather than NOLHGA, because it is at the local system or the local organization where all of the action is. I think this hearing is focused inappropriately on the role of NOLHGA in these insolvencies.

With respect to specific insolvencies, the way the guaranty associations work is they form committees of themselves to address how to respond to a specific insolvency. And members of these committees are not employees of NOLHGA, they are not contractors of NOLHGA. These committees are very independent and it's at the local level where these decisions about coverage, these decisions about which insolvencies or what to do in a particular insolvency are made.

These associations are fiercely independent. NOLHGA has no role in making those decisions, other than to facilitate the coming together of those associations. And at that level, Senator Thurmond, I favor public representation.

Senator THURMOND. As I construe your answers then, all three of you take that position?

Mr. BLAINE. Yes, sir.

Mr. SIMMONS. Yes.

Mr. DUMMER. Yes.

Senator THURMOND. Thank you very much. Thank you, Mr. Chairman.

Senator METZENBAUM. Thank you, Senator Thurmond.

Mr. Blaine, a number of guaranty funds told NOLHGA that they felt Security Benefit, not the guaranty funds, was liable. The Tennessee Guaranty Fund told NOLHGA at a meeting of guaranty funds on December 20, 1990, that it considered Security Benefit liable. Tennessee said that unless policyholders consent to a policy transfer, a transfer is not valid.

Consequently, Tennessee concluded that "SBL was on the hook." Are you aware of that?

Mr. BLAINE. I have read the correspondence, yes, Mr. Chairman.

Senator METZENBAUM. NOLHGA records show that the Arizona Guaranty Fund representative then told the meeting "Tennessee's issue should be buried, not be addressed." It wasn't addressed.

Is that an example of NOLHGA's accountability, ignoring questions about the legality of spending taxpayer's money?

Mr. BLAINE. I don't believe the Tennessee concern went unaddressed. As a matter of fact, I believe the files and the records in the files would indicate that then president of NOLHGA visited with the Tennessee board and discussed the case further with them. There is no record of what was said, but there is a clear indication that it was addressed and that the concerns of each of the guaranty associations who raised objections were indeed addressed.

Senator METZENBAUM. Well, the Indiana Guaranty Fund, also had reservations. It wrote NOLHGA that:

> It appears very likely that Security Benefit has obligations to the annuity holders. It is the conclusion of our executive committee that the court should decide whether Security Benefit is liable.

The Texas Insurance Department also believed Security Benefit was liable. NOLHGA received a legal opinion from the chief lawyer for the Texas department. It said:

> SBL is still liable. It is our position that article 21.28–D of the Texas insurance law would not provide a basis for any contribution by the Texas Life Accident, Health and Hospital Insurance Guaranty Association. It is our intention to inform NOLHGA that Texas will not be participating in the DBL–LACOP SBL proposal unless we hear otherwise from you.

Did NOLHGA just ignore the Indiana letter and the Texas opinion?

Mr. BLAINE. No, indeed, and again I believe the file showed that Texas subsequently changed its position, as did Indiana, and they both agreed to participate. One thing that should be made clear for the record, too, Senator. While much has been said about the liability of Security Benefit Life for these blocks of policyholders, the law on that will vary from State to State. Some States may have a clearer ruling on who's responsible in that situation than other States.

Senator METZENBAUM. Can you tell me any State that says that an insurance company may lay off its responsibility to its policyholders by assigning the policy to another insurance company?

Mr. BLAINE. I'm not an expert in that area, but I believe——

Senator METZENBAUM. I have a very, very important call, will you please excuse me. The subcommittee will be in recess.

[Recess.]

Senator METZENBAUM. The Chair apologizes for the necessity of taking that call.

Mr. Blaine, before NOLHGA waived the right to sue Security Benefit, it seems to me that NOLHGA should have known that Security Benefit had a poor legal case. There was a default judgment in 1989 against Security Benefit in a lawsuit filed by an annuitant and Security Benefit settled lawsuits by several individual annuitants in 1990, paying the whole amount of the annuities and the annuitants legal fees, rather than fight the lawsuits.

Did NOLHGA ask Security Benefit if it had settled any lawsuits or been sued?

Mr. BLAINE. I don't know whether that question was asked of Security Benefit Life, Mr. Chairman, but the fact of the matter was Security Benefit Life was willing to litigate this issue and the overriding concern, again, was that we resolve this short of litigation. We were under a lot of pressure from State insurance departments. They were leaning on the guaranty associations in their States to get this resolved. Policyholders were complaining to their State guaranty associations. The NAIC was on the back of the guaranty associations to get this resolved without protracted litigation, and that was the whole goal.

Senator METZENBAUM. You say that Security Benefit wanted to litigate it. In what manner did they make that known?

Mr. BLAINE. That became very evident both in the meetings with their representatives, from what I've read in the file, and also from the fact that they were in litigation, as you I believe said earlier. There was a case decided in the Federal District Court in Western Kansas, litigated over an annuity.

Senator METZENBAUM. And every one Security Benefit lost. Every time they wound up paying the full amount. Texas and Indiana say you shouldn't pay it, but Security Benefit settled for the full benefit of the annuities with some annuitants. NOLHGA could have paid the annuitants and then sued Security Benefit to recover your costs. That way the taxpayers would not have paid for the liability of a solvent company.

I have difficulty in understanding why NOLHGA would waive their right to sue Security Benefit and making a settlement when they only contributed a pittance to it. They contributed $7 million to a settlement of $30 million.

Mr. BLAINE. Again, Mr. Chairman, let me repeat that Security Benefit Life clearly indicated that they were willing to sue the guaranty associations if they were made liable for these policies without any contribution from the guaranty associations.

We did not need to get into litigation with that company and drag out the settlement of this problem.

Senator METZENBAUM. I think that the way NOLHGA handled this Security Benefit situation actually raises a question about whose interest NOLHGA actually serves. I think it's pretty clear that NOLHGA was involved in Security Benefit to avoid a challenge to the industry's practice of assumption reinsurance which is the transfer of policies without policyholder's consent.

If there is any abominable practice that I can think of in the insurance industry, it's the matter of transferring policies with policyholder's consent. When NOLHGA first convened the guaranty funds to discuss a settlement on December 20, 1990, protecting the

involuntary transfer of policies was on the agenda. We obtained NOLHGA's staff notes of the meeting.

The show that NOLHGA's then president informed the group that it would be doubtful for the industry to continue to do assumption reinsurance. It would appear that NOLHGA was using taxpayer's money to prevent the involuntary transfer of policies from being challenged. Would you agree with that?

Mr. BLAINE. No, I don't agree with that. I don't think what we were doing was an attempt to defend assumption reinsurance transactions, which I might add we do participate in with the insurance receivers ourselves. When a company becomes insolvent, Mr. Chairman, their policies are typically protected by selling them to a solvent company, so that they don't lose their life insurance and health insurance protection.

Senator METZENBAUM. I understand that, but we're talking now about going from a solvent company to an insolvent company, a totally different picture.

Mr. BLAINE. Well, it started, though, Mr. Chairman—remember SBL bought the business from an Arkansas company that was going insolvent initially. Now sure, they sold it later to a company that was at the time solvent and later became insolvent. I'm not defending what was then a fairly routine business transaction of selling blocks of business without obtaining the consents of policyholders when it was made between two solvent companies.

We were not there—I don't think that was the role of NOLHGA or the State guaranty associations, who are really the parties in interest here. I don't think that was ever their goal, was to defend the transaction.

Senator METZENBAUM. Mr. Simmons, it appears to me that NOLHGA and the NAIC were responding to the industry, not to the annuitants. The annuitants had filed a class action lawsuit against Security Benefit alleging that the transfer to LACOP without their consent wasn't legal. NOLHGA did nothing for the annuitants for nearly 2 years. You acted only when the class action lawsuit got serious.

A Pennsylvania Guaranty Association memo pretty well sums it up. It says:

> There is concern that if the guaranty associations don't do something pressures will increase for a Federal solution. There is a feeling within NAIC and perhaps the industry that pending class action litigation, if allowed to continue to its conclusion, would have an adverse impact on assumption reinsurance transactions in general.

Mr. Simmons, does that sound like an NAIC worried about the policyholders, or an NAIC worried about the adverse impact on assumption reinsurance?

Mr. SIMMONS. Senator, that document wasn't written by the NAIC. I've never seen the document that you're referring to, to my knowledge. NAIC was certainly worried about the policyholders and annuitants. That was our only concern at the time, and Mr. Blaine's right. His membership, the State guaranty associations were getting great pressure from the NAIC individual members to get this thing settled. That was to settle it any way that it could be done, to end this standoff that was going to take years in the court systems to get those annuitants paid.

At the time we heard about the problem, we being the NAIC, it was the fall 1990. They hadn't been serviced in nearly 2 years. The membership of the NAIC was not content to see more and more litigation. The total sum at stake here was around $30 million. Not a great deal of money, certainly more than any of us carry around, but comparative to other insolvencies, it wasn't terrifically large, that we felt like these annuitants should have to continue to wait 2, 3, 5, 10 more years for litigation to be ultimately resolved.

So our members were very concerned about the annuitants and putting a great deal of pressure on the individual State guaranty associations to quit litigation and fighting between each other and get these people paid.

Senator METZENBAUM. Well, why didn't you pay them off and then go ahead and sue SBL?

Mr. SIMMONS. Well, the NAIC wasn't the architect of the final plan. We just wanted a plan. But I will say that SBL would have had no incentive to participate, which would have adversely affected the consumers. With SBL's participation in this overall plan, the consumers got 100 percent of the money they had put into it back, as they would have if they had stayed with SBL.

If the guaranty associations, I'm sure, had taken the posture that they would just front it themselves and sue Security Benefit, then those people who weren't fully covered by the guaranty associations would not have been full paid.

Senator METZENBAUM. Mr. Simmons, are you not embarrassed about the fact that the taxpayers are called upon to bail out Security Benefit Life when Security Benefit Life was fully capable of meeting its own obligations? Doesn't that embarrasses you, in that the NAIC—although not directly involved—was certainly a participant with the end result?

Mr. SIMMONS. Well, sir, I don't agree that the taxpayers bailed out Security Benefit Life, so I'm very proud of the NAIC.

Senator METZENBAUM. What do you mean? How do you tell me that they didn't? If you get a credit against paying the taxes, if there's some deal I make with you and as a consequence I can take $10,000 or $50,000 or $100,000 off my taxes, do you mean to say that that isn't a taxpayer?

Mr. SIMMONS. I would like to answer that on two levels, if I could. One, I don't see the credit as being the same as with the banks and the savings and loans, that the tax coffers of the U.S. taxpayer goes into making the payments. The reason I don't—I mean, I compare it personally to the credit I take for child daycare providers, and that's about 20 percent of what I pay in. I don't consider that the Federal Government's money. It's just money that for some reason I didn't have to pay, that I otherwise would have. But that's not the most important factor.

Senator METZENBAUM. Let me get this straight now. The credit you take for daycare expenses, you are now comparing to the insurance company offset against their obligation——

Mr. SIMMONS. No, sir. I'm saying that I don't consider that the——

Senator METZENBAUM. I'm a little shocked by that. You sort of woke me up.

Mr. SIMMONS. I don't consider that the U.S. taxpayer is paying for me, financing if you will, me to hire someone to set with my children because that's a tax credit that I'm getting. That's not the most important level.

I think more importantly than that is the fact that Security Benefit, its liability may or may not have been there.

Senator METZENBAUM. It was there. The courts found it there.

Mr. SIMMONS. It had exposure, Senator.

Senator METZENBAUM. They paid off everybody who had sued them. How can you tell me there was a question about their liability? If I owe you $1,000 and you come to collect and I say I question whether I owe it. But the fact is, I owe it to you. I signed a note to pay it to you.

Now you're saying to me, well there's a question. There was no question. There wasn't any court that ruled in their favor. There wasn't any time they were willing to go to trial. They paid off. They paid the lawyers for the annuitants before going to trial, and you say there was some question.

There wasn't a scintilla of evidence that Security Benefit Life was liable. And you sit here and tell me well, there was some question. That's B.S. I don't buy it. Tell me how you get to the point where there was a question. Where?

Mr. SIMMONS. Senator, I am not aware of who they settled cases with or what the circumstances of their settlement were. The one case that I'm aware that was decided against them was the case with the FDIC, which they set aside as being reserved and a special circumstance all along.

I don't know under what circumstances they settled. If they settled at all, maybe they had a liability, maybe they didn't. I don't know. I wasn't called to ask that, but I knew that if they continued to litigate that issue, as every indication was, it was probably going to be 5 more years before these annuitants got any money.

Senator METZENBAUM. Then you could have paid them off and then gone after SBL. Instead, you gave up the money. You gave $23 million.

Mr. SIMMONS. We didn't, at the NAIC. We encouraged the guaranty associations.

Senator METZENBAUM. This is only an example. It isn't all the money in the world. We deal with billions here, so $23 million is—we use this as an example here today of the kinds of arrangements and the protections that aren't provided by NOLHGA and the NAIC to the taxpayers of the country and to the insureds of this country. Now the insureds came out all right in this instance. We have other examples where the insureds don't come out all right, and you don't always protect the situation where there is a selling of policies.

You don't have anything now in your records, your recommendations by the NAIC, and you don't contemplate anything, to preclude the selling of policies from one company to another without the consent of the policyholder. You have nothing. You're not contemplating anything. You're talking about sending out some kind of notice or something. But the fact is, you're letting down the insureds. And that isn't what you're supposed to be doing. You're

supposed to be concerned about them, instead of carrying the water for the insurance companies for this country.

And too many of your people are doing that. That's what gets people upset. I talked with another Senator yesterday about this very subject. He couldn't believe that insurance companies were selling policies. It's as if General Motors had a warranty on all the cars they sold, and then suddenly assigned all of their responsibilities to the PDQ Co. and told everybody to go get your collection on your warranty from the PDQ Co. That's the same thing.

And you people are sitting there twiddling your thumbs and figuring out how can we do it with sending them some little notice, or we'll tell them if they don't react within 1 year, that they have to object. The average American doesn't have the capacity to react in dealing with an insurance company.

And you people are supposed to be doing something to protect them. You're not doing your job. Let's not kid ourselves. You're sitting on your hands and you're looking forward to the day when you can go to work for the insurance company.

If I sound angry, it's because I am angry.

Mr. SIMMONS. Well, Senator, the membership may eventually come around to your way of thinking, and they have two more levels to get through before they do. Right now, they've certainly considered your comments and appreciated them. But so far, they haven't agreed that it would be the best overall interest of U.S. policyholders to prohibit assumption reinsurance. They haven't to this point.

Senator METZENBAUM. Mr. Simmons, the National Association of Insurance Commissioners is made up of the insurance commissioners of the 50 States. In most States, the commissioners are the only public officials with oversight of guaranty funds. If the commissioners don't monitor the funds' operations, if they fail to counter industry domination of the funds, there will be no public oversight of the funds, which will spend millions of tax dollars.

The NAIC's involvement with the Security Benefit settlement began with an August 31, 1990 meeting at NAIC headquarters, requested by Security Benefit. Is that correct?

Mr. SIMMONS. I'm not sure if it was a meeting or a phone call. That's the first time I have any recollection of hearing it though, the date.

Senator METZENBAUM. Your records do show, though, that it was SBL that asked for the meeting?

Mr. SIMMONS. An attorney for Security Benefit, yes.

Senator METZENBAUM. And the meeting was attended by lawyers for Security Benefit, you, and the then chairman of the NAIC, is that correct?

Mr. SIMMONS. Senator, if that's what my records that you've seen show, I would agree with that.

Senator METZENBAUM. Why were none of the affected annuitants in the meetings or a spokesperson for them?

Mr. SIMMONS. Well, I don't think at the time that I personally knew of any annuitants. I didn't know of any of the litigation that had gone on. Certainly, at the time I was called, I didn't know that it had been 2 years since they'd been serviced. This was a preliminary meeting to see if the NAIC could do anything.

Senator METZENBAUM. Did the NAIC ever meet with any of the affected annuitants?

Mr. SIMMONS. The NAIC didn't, to my knowledge. Individual commissioners, I'm sure, did.

Senator METZENBAUM. Are you sure that they did?

Mr. SIMMONS. I couldn't swear to it, Senator Metzenbaum, but I have a firm recollection that at least one or two of the commissioners told me that they had met with some of the annuitants.

Senator METZENBAUM. The subcommittee did obtain, you're correct, a Security Benefit memo describing the meeting. The memo says Security Benefit's lawyers asked the NAIC chairman to convene a group of commissioners to help get the Arizona Guaranty Fund to pay off the policyholders. It says the NAIC chairman agreed to assemble such a group to pressure the guaranty fund system to pay off the policyholder. Is that your understanding of what occurred?

Mr. SIMMONS. I would say essentially we obviously didn't see that memo. We did agree to try to get—at that time, it was only the Arizona Guaranty Fund that was involved. The Life Assurance Co. of Pennsylvania was not yet found to be insolvent or in a receivership proceeding. The general context of that I would probably agree with.

We agreed to convene a meeting, as I said in my opening statement, and put pressure on the guaranty associations to get these people paid.

Senator METZENBAUM. The NAIC adopted an unprecedented resolution at its December, 1990 annual meeting, which clearly helped Security Benefit. It "strongly urged" the guaranty association to take "immediate action" to pay off the policyholders who were suing Security Benefit. In effect, it called for a guaranty fund bailout of a healthy company.

Do you know of any resolution like it, urging the guaranty fund system to take action regarding a particular company? This is from your organization to the guaranty funds?

Mr. SIMMONS. I really haven't studied that, Senator. I don't know if it would be unusual. I would disagree with the characterization that we were urging the guaranty association to pay off the people that had sued Security Benefit. We didn't know who those people were, and I'm not even sure it was a certified class action lawsuit at that time. It could have been, I don't know. It was to pay off all of these annuitants.

Senator METZENBAUM. Mr. Simmons, the NAIC resolution appears to address the problems of the annuitants, but the special committee assigned the matter was the Special Committee on Assumption Reinsurance. It appears to me the NAIC's chief concern was the industry's ability to do assumption reinsurance if the policyholder's class action lawsuit was allowed to continue. Am I correct about that?

Mr. SIMMONS. No, sir, I think it was two different groups. This group that was looking at this particular transaction, as I said, was kind of an ad hoc group consisting of States that had a particular interest in this particular matter. We formed, underneath our reinsurance task force, a working group that was concentrating on assumption reinsurance, and in fact, still are.

Some of those members are the same. I know Illinois was one State that served on both. I don't believe that they were the same membership. They weren't the same committee.

Senator METZENBAUM. Let me turn to Mr. Dummer. Mr. Dummer, in inviting you to this hearing, the subcommittee staff asked directory assistance for the number of your consulting company, the Donner Co. Their call to Donner's number was answered guaranty association.

We subsequently learned that the Utah Guaranty Association shares office with, has the same phone number as, and is staffed by your consulting company. In addition, you are the managing secretary of the guaranty associations. Am I correct on my facts so far?

Mr. DUMMER. Not quite, but close enough.

Senator METZENBAUM. Am I correct on any portion of it?

Mr. DUMMER. The Donner Co. is the managing secretary of the guaranty association, not me personally.

Senator METZENBAUM. Mr. Dummer, the Utah Guaranty Association participated in the security benefit settlement. At the association board meeting on November 11, 1991, the board's minutes show that you participated and made the presentation to the board. The minutes state that the association was authorizing expenditures for a problem that "relates to the assumption, reinsurance involving Security Benefit Life and Life Assurance Co. of Pennsylvania or LACOP." Am I correct on that?

Mr. DUMMER. I guess so.

Senator METZENBAUM. It is my understanding that your company was involved in the transfer of the annuities from Security Benefit to LACOP. The Donner Co. actually put the transfer together, as I understand it, acting as the consulting actuary and reinsurance broker. Security Benefit paid your company a fee, is that correct?

Mr. DUMMER. That's correct.

Senator METZENBAUM. Your company was paid by Security Benefit to work on the transfer of the policies. Later, when that transfer became the issue on whether the guaranty fund should pay off the policies, you participated in the guaranty association's decision to pay them off. I'm not suggesting you did anything illegal, but there seems to be no question that you had a conflict of interest that required you to abstain from participating in the Utah Guaranty Association's decision.

Do you agree that you should not have participated in the association's decision?

Mr. DUMMER. Mr. Chairman, I did not participate in the association's decision. I had no authority or power whatsoever with respect to the decisions the Utah Guaranty Association makes. They ask me, as the administrator, simply to brief them and explain the transaction, which I did.

I also explained, by the way, that the Donner Co. had been the broker for the original transaction.

Senator METZENBAUM. Before the association decided to pay off the policies, a number of things happened that indicated that Security Benefit might be liable for the policies. The Arizona Guaranty Association declared in court that it was not responsible for paying

off the polices because they had not been transferred to Diamond Benefit Life with policyholder consent. That position meant that either Security Benefit or LACOP was liable. In addition, Security Benefit had actually paid off several individual policyholders who sued.

Were you aware of the Arizona association position and these actions of Security Benefit when the Utah Guaranty Association paid off the policies?

Mr. DUMMER. Yes, we were.

Senator METZENBAUM. Mr. Dummer, one provision in the Security Benefit settlement was the Utah association agreeing to release Security Benefit from any liability it might have on the policies. Before this association decided to pay off the policies did you, as the managing secretary, get a legal opinion that Security Benefit was not liable for the policy? And if not, why not?

Mr. DUMMER. We did not, Mr. Chairman, and the reason we did not was because after consideration of the various pros and cons involved in the settlement, the board felt that since our participation was so miniscule, that it was really not worth the expenditure of funds.

Senator METZENBAUM. Am I correct in my understanding the insurance companies in Utah that pay assessments into the guaranty fund can take a credit against the State taxes for those payments?

Mr. DUMMER. They take a credit over 5 years.

Senator METZENBAUM. In effect, the Utah association decision then resulted in Utah taxpayers, over a period of 5 years, paying off policies that were the responsibility of Security Benefit. You had been involved in making the transfer of Security Benefit to LACOP. Did you advise the association that it and other guaranty associations should insist on the right to sue Security Benefit to determine whether it was liable?

Mr. DUMMER. No, sir.

Senator METZENBAUM. The Utah Guaranty Association has a board of directors of nine individuals. All nine are executives of insurance companies. Three of the nine members are from outside Utah, one from New York, one from California, and one from Colorado. These nine insurance executives, with your assistance as the managing secretary, are making decisions about Utah tax dollars.

The membership of virtually every other State guaranty association is similar. Frankly, I'm concerned about who represents the public and the taxpayer's interest. Do the three out of State insurance executives represent the interests of the taxpayers of Utah?

Mr. DUMMER. I believe they think they do.

Senator METZENBAUM. It's pretty hard to contemplate, don't you think, that if I were sitting on that board——

Mr. DUMMER. I think that they believe that their interests, Senator, are congruent, substantially congruent with the interests of the taxpayers of Utah.

Senator METZENBAUM. I want to thank this panel. You've been very cooperative. Mr. Simmons, I apologize to you for raising my voice. I was so upset of the failure of your organization to meet its responsibilities, that I guess I just——

Mr. SIMMONS. That's quite all right, Senator. I hope we can dissuade you from the opinion that we're not doing our job, but I understand your strong feeling on the subject.

Senator METZENBAUM. Mr. Simmons, see that your organization protects the policyholders. What your contemplating doing is really not right. No policyholder in this country, with maybe 1-percent exception, will understand when they get some notice from an insurance company that the policy has been assigned and unless you object, it will become—we will no longer be liable. I'm not sure it will even say that.

People don't understand that. The American people are not that intelligent. Most forms that come through have so much gobbledygook on them, that the average American can't comprehend. And if he or she does comprehend, he doesn't know what to do about it. If there's no liability, he just assumes you're decent people. Most of you are decent people, and that there's no larceny intended.

But the fact is then they go to collect and they need a lawyer. I just say to you no other business would think of assigning a contract and relieving itself of liability—I mentioned General Motors or any automobile company that has warranties—nobody would think of assigning those obligations and not remaining liable to the individual. It wouldn't be permitted as a matter of common law.

I just implore, I entreat with you, don't let your organization let down the American policyholders by permitting these assignments and assumption of insurance without protecting them. It just isn't fair, and it isn't right, and you're too well respected an industry to be engaged in this kind of—really, it's chicanery. When you and I have a contract and you assign it to Mr. Dummer, and you get off the contract, that's just not right. That's not what you could do in any other field of law. The insurance commissioners shouldn't permit it to be the way it is in this field of law.

Thank you very much.

Our next panel, I thank them, Mr. Simmons and Mr. Dummer. Mr. Blaine is staying on.

Our next panel consists of Mary Griffin, counsel of the Consumers Union of Washington; Jack Blaine, who has been with us; and Joseph Belth, who has been with us on previous occasions, professor of insurance, School of Business, Indiana University, Bloomington, IN. He's also the editor of the Insurance Forum.

Why don't we start off by hearing from Mary Griffin, counsel of Consumers Union.

PANEL CONSISTING OF MARY GRIFFIN, COUNSEL, CONSUMERS UNION, WASHINGTON, DC; JOSEPH M. BELTH, PROFESSOR OF INSURANCE, SCHOOL OF BUSINESS, INDIANA UNIVERSITY, BLOOMINGTON, IN, AND EDITOR, THE INSURANCE FORUM

STATEMENT OF MARY GRIFFIN

Ms. GRIFFIN. Thank you, Mr. Chairman.

Consumers Union appreciates the opportunity to present our views about the current system. I'd like to address two major issues today about the current guaranty fund system. One is the lack of accountability and public participation in the process.

Senator METZENBAUM. Could you pull your mike over? Thank you.

Ms. GRIFFIN. The two issues I'd like to address today are the lack of accountability and public participation in the process, and the overall lack of oversight on a national level.

Guaranty associations are created by State statutes to protect policyholders in the event of insolvencies. As you've discussed with the first panel, while the industry provides the initial outlay of funding, it is the public that ultimately bears the majority of costs for mechanisms such as premium tax offsets the industry has at its disposal.

Despite the fact the taxpayers have been called on time and again to bail out the insurance industry, the public has virtually no voice in the process. As you've pointed out, with very few exceptions, guaranty association boards are comprised solely of industry members. NOLHGA is also made up of industry representatives and is subject to no formal regulatory oversight.

We have advocated before the NAIC for inclusion in the model act of public representatives on guaranty association boards. Unfortunately, the industry and NOLHGA vehemently opposed our suggestion. In opposing public participation, the industry representatives argue that the public members should be excluded because they will "blab to the press."

The assert that the public is already represented by the regulators, so there's no need for additional public members, and that the public's participation would cause a conflict of interest. But the real fear is that the public members will hold the industry accountable and business as usual will not be tolerated.

In discussions with the few public members there are in the system, they liken the situation to that which exists among doctors, a closely knit atmosphere in which colleagues protect each other and fail to take action or rat on their friends. They firmly believe that public members are necessary and should be required to bring accountability to the system, a system as one member characterized it, which involves public "financing of rampant mismanagement."

The industry not only controls the decisionmaking process of guaranty funds, but also the information flow which is essential for the system to work effectively. The public members I spoke with expressed utter frustration over the lack of information and data available to them and the inertia of those in the system.

Over the past 2 years, I've been involved in several committees charged with making recommendations to regulators on how to improve the current system. In trying to assess the guaranty fund system, I too have been extremely frustrated about the lack of information. NOLHGA and guaranty associations do not compile and analyze data for public consumption. They do not perceive that as their role.

Regulators and the public alike lose out in this system. For those who control the information, control the debate, and therefore control the policymaking process. As you know, the FTC is not even allowed to conduct economic studies on the business of insurance. Thus, no impartial body exists to objectively describe the insurance marketplace.

The 50 State system creates inefficiencies, duplication of costs and efforts and delays for policyholders. It lacks the centralized management structure, a single entity to which people can communicate. Depending on the State of residence, consumers may or may not be covered and are rarely apprised of this fact.

Many of the deficiencies are the result of a State-based approach to a problem national in scope. States do and should protect their citizens, but when large multi-State insolvencies are at issue, the parochial needs of the States interfere with obtaining equitable treatment for all claimants.

The NAIC, a private association, provides the only national quasi-regulatory coordination on insolvencies. While NAIC's accreditation program has brought significant changes at the State level, as GAO recently stated, NAIC's ability to successfully sustain the program over the long term without the inherent authority to enforce its standards is questionable.

GAO referred to NAIC as a catalyst for encouraging State departments to do better, but the public needs more than a catalyst. It needs a regulatory structure with power to enforce standards. The public members and others working in the system asked me to convey to you the need for a national system. The problems and need for oversight on the national level are great.

As one pointed out, the system cannot be effective until statutory provisions which mandate uniform and efficient data collection and analyses, public participation, and an entity with the ability to determine causes and solutions are enacted. And of course, information must be made available for public consumption.

Consumers need a national system to make sure that they get a fair shake. We need to move away from the day when we hand over wholesale to the insurance industry the power to determine which and how companies get bailed out.

We thank you for your leadership in the area of insurance regulation and especially for inviting us to present our views.

[The prepared statement of Ms. Griffin follows:]

PREPARED STATEMENT OF MARY GRIFFIN ON BEHALF OF THE CONSUMERS UNION

Mr. Chairman and Members of the Subcommittee, Consumers Union [1] appreciates the opportunity to present our views on important consumer issues relating to the guaranty fund system. We commend you for your leadership in the area of insurance. In *Consumer Reports,* we have written extensively about insurance products, most recently with our three-part series on life insurance. We have also been involved in efforts before Congress and at the National Association of Insurance Commissioners to dismantle the laws and traditions that have long shielded the insurance industry from fundamental rules of fair play and consumer protection.

In this testimony, we would like to address two major concerns about the current system of insurance guaranty funds: the lack of accountability and public participation in the process and the overall lack of oversight on a national level of the guaranty fund system. We also offer some ideas for how to improve the system.

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[1] Consumers Union is a nonprofit membership organization chartered in 1936 under the laws of the State of New York to provide consumers with information, education and counsel about goods, services, health, and personal finance; and to initiate and cooperate with individual and group efforts to maintain and enhance the quality of life for consumers. Consumers Union's income is solely derived from the sale of *Consumer Reports,* its other publications and from noncommercial contributions, grants and fees. In addition to reports on Consumers Union's own product testing, *Consumer Reports,* with approximately 5 million paid circulation, regularly carries articles on health, product safety, marketplace economics and legislative, judicial and regulatory actions which affect consumer welfare. Consumers Union's publications carry no advertising and receive no commercial support.

NEED FOR PUBLIC ACCOUNTABILITY AND PARTICIPATION

There exists a rather pervasive attitude among members of the industry that the money held by a company is that company's money and it should be able to do with that money what it likes. Since one of the reasons behind insolvencies can be traced to a lack of accountability, and since most policyholders of life or annuity policies contract with the insurance company with the expectation that the company will hold the money in trust until such time as it is needed by the policyholder or their beneficiary, public accountability should be injected into this process. The public deserves more representation in the process; the more accountable the industry is, the better off the public is.

The public bears the cost of the system and should participate in the system. Despite the fact that the public has been called on time and again to "bailout" the insurance industry, the public has virtually no voice in the process. While the industry provides the initial outlay of funding for this system, it is the public—taxpayers and consumers of insurance—that bears the ultimate cost of this system through a variety of recoupment mechanisms available to the industry. Currently, 40 states provide premium tax offsets for assessments,[2] the mechanism by which guaranty funds are created. In addition, companies can deduct on their federal and state taxes the costs of assessments.

According to testimony before this Subcommittee, of the $179 million assessed in 1990, approximately 79 percent will be borne by state taxpayers, 7 percent by federal taxpayers and 14 percent by policyholders, equityholders and employees.[3] For 1991 assessments, taxpayers can look forward to paying much more, as the 1991 assessments topped $570 million, a more than 300 percent increase over 1990 figures.[4]

And the tax system is just one method by which the public and policyholders bear the costs of insolvencies. Policyholder surcharges, deductibles and recoupment through increased premiums are other methods the industry has at its disposal to spread the risks of loss far and wide and away from them. While we acknowledge the need for a place for industry at the table, it is critical that the public be seated there as well.

Public participation is needed to provide a new and different perspective on guaranty association boards. With very few exceptions, guaranty association boards are comprised solely of industry members. The National Organization of Life and Health Insurance Guaranty Associations (NOLHGA) represents the state guaranty associations in insolvencies and provides coordination, technical assistance and guidelines and serves informal policymaking functions to the various state associations. That organization is also made up of industry representatives and is subject to no oversight except for that provided by the courts in specific cases.

These boards are created by state statute which provide the limits, exclusions and caps on coverage for claimants. The boards decide coverage issues, settle claims and often interpret certain provisions which may or may not result in protection for certain claimants. The associations also have some degree of control over how quickly claimants get paid. The statute also provides authority for the board to make recommendations to the commissioner concerning the detection and prevention of insolvencies as well as matters germane to the solvency of any insurer in the state.

Decisions and reports of the associations have implications for individual policyholders as well as the general public and consumers of insurance. These associations should not be comprised only of insurance companies who may advocate for their own interests. The public representatives can point out problems and issues that may not be apparent or articulable by the industry or they can advocate for a more speedy claims payment process. And, most importantly, they can hold the industry accountable to those who pay for the system—the public.

For the past year and a half, we have advocated before the National Association of Insurance Commissioners (NAIC) for the inclusion of public representatives on guaranty association boards in the model act. We have been met with unanimous opposition from the industry and NOLHGA. The arguments against public representation and the nature of the debate point to the need for different and new perspectives in the process. These industry representatives argued that the public members

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[2] "Issues Concerning Insurance Guaranty Funds," Robert Klein, NAIC, presented to the NAIC Guaranty Fund (EX4) Task Force, June 1992, Tables.

[3] "Distributing the Cost of Protecting Life-Health Insurance Consumers," statement of James Barrese and Jack M. Nelson, The College of Insurance, before the United States Senate Committee on the Judiciary, Subcommittee on Antitrust, Monopolies, and Business Rights, April 28, 1992, at 1.

[4] Life and Health Guaranty Association Assessments by Account 1972–1991, National Organization of Life and Health Guaranty Associations.

will "blab" to the press; that they will lack the necessary technical expertise; and that their participation would cause a conflict of interest. These arguments border on the ridiculous, particularly in light of the fact that the companies which sit on these boards are all competitors which raises greater concerns about conflict of interest issues and leaking information to the press.

One of the arguments repeatedly expressed against the inclusion of public representatives is that the commissioner represents the public and since he or she is always involved in the guaranty associations, the public is well-represented. This argument misses the point and demonstrates the need for the perspective of the public. While commissioners and departments of insurance must look out for the public and act in the public's good, they are also charged with regulating solvency concerns. The commissioner balances the needs of the industry with the need to protect the public. The commissioner acts as a judge, charged with deciding between two positions or striking a balance between them. The industry has been well represented in this process, why is it the public cannot be?

The public needs information for the system to work and to assess the effectivenessof the system. The current guaranty fund structure is based on certain incentives. The fundsare designed as partial safety nets with caps and limits on coverage to serve as incentives for people to shop wisely, investigate the company's financial strength and theoretically stay away from financially troubled companies. In this way, unstable insurers will be driven out of the market because there will be decreased demand. But in order for these incentives to work, people must have access to information.

One source of information people are directed to rely upon are the various rating services. But, as we asked in our July issue of *Consumer Reports,* "Can you trust the graders?" Perhaps not. One month before New Jersey regulators took over Mutual Benefit, A.M. Best had given it an A+, its highest grade at the time. While the ratings for Executive Life were not so glowing, they were certainly not indicative of a doomed insurer one month before the California department took it over. And ratings companies are not only paid for by the industry they rate but also often base their ratings on information provided by the companies themselves, which may be skewed to get better ratings.

To assess the effectiveness of the guaranty fund system, the public must also rely upon an industry controlled process. Over the past two years, I have been involved with several committees made up of mostly industry members charged with advising regulators on the effectiveness of the current system. As the only consumer representative, I requested information on several occasions relating to the number of and particular types of claims, certain costs of the system and other data that would be useful to carrying out our charge. Much to my surprise, according to NOLHGA and industry members, no where was that information collected or available in any coordinated form. In addition, there were often differing views on the nature of the information and what it would reveal. The fact that important recommendations are being made to regulators without the benefit of impartial information and analyses points out a tremendous weakness in the system.

Consumers would benefit from a structure charged with authority to oversee and study the insurance industry. Those who control the information control the debate and therefore control the policymaking process. Until a public entity with the power to enforce standards, charged with developing expertise and with the directive to report to the public, we will never achieve a true "debate" or a representative decision-making process. In the absence of some system of national oversight, the public cannot benefit from studies and analyses and open discussion because so much of the debate goes on behind closed doors in the absence of objective, impartial information from non-industry experts.

Consumers need simplified information about how the system ostensibly protecting us is working. That information includes:

—what percentage of policyholders' claims are being paid and are covered by the caps;
—what is the extent of loss from these insolvencies;
—who is involved in making decisions affecting policyholders;
—what problems do the types and nature of insolvencies point out in the overall system of insurance regulation;
—is this the most efficient way for dealing with insolvencies;
—are the theoretical incentives working in reality;
—how quickly are claims being paid;
—where are the former principals of insolvent companies working now; and
—how quickly is information getting out to the public.

In the absence of public participation and demand for accountability, a system paid for by the public and established under authority created by statute cannot serve the needs it is designed to address.

NEED FOR A NATIONAL REGULATORY SCHEME TO OVERSEE AND COORDINATE THE SYSTEM

The purpose of guaranty funds is to protect policyholders of an insolvent insurer. But only through a uniform system of guaranty funds can all consumers be assured of protection from insurer insolvency. The current system is a patchwork of funds that cover different categories of consumers and types of policies and include varying levels of assessments and liability limits. This system fails to take into account the national and interstate nature of the insurance industry of today. Depending on the law of the insurer's state of domicile and the residence of the policyholder, a policyholder may not be protected by a guaranty fund—an inequitable outcome given the fact that most consumers are probably not aware of this risk nor would most consumers conclude that insurance policy protection was related to the state in which they reside.

The system currently in place was designed for different types of insolvencies and has not adequately adjusted to the needs and demands of the current environment. At the time the current system, based on the NAIC Life and Health Insurance Guaranty Association Model Act written in 1970, was developed, a much different "insolvency" environment existed.

Between 1972 and 1981, life and health funds had been assessed approximately $42 million.[5] In the following ten year period, from 1982 to 1991, the total assessments increased more than 28 times to $1.2 billion.[6] The number of insolvencies are equally as startling. Over the past four years, there have been 143 insolvencies, more than twice as many than in the previous four years. Needless to say, the scope and nature of insolvencies has greatly expanded. Some of the problems identified with the current state-based system include:

- Variations in guaranty fund laws in such areas as covered lines, exclusions, deductibles, and caps resulting in inequitable treatment to claimants.
- Inequitable distribution of costs of the system leaving taxpayers to bear the bulk of the burden.
- The capacity of the system is insufficient at the individual state level, leaving some states with insufficient funds either in total or in a particular account. This can result in moratoriums or delays in payments or reduced levels of payments for policyholders.
- Lack of efficient and uniform system for data flow causes delays in the system and an inability to aggregate much needed data.
- The fifty state system creates inefficiencies, duplication of costs and efforts, and delays. It lacks a centralized management structure, a single entity to which people can communicate, particularly in those insolvencies involving large multi-state companies.
- Poor integration and coordination among receivership laws and between receivership laws and guaranty fund laws which adds to inefficiencies, delays and confusion, particularly for policyholders.
- Consumers lack knowledge of the existence of the guaranty funds, limitations on benefits and caps on coverage.

Many of these deficiencies are the result of a state-based approach to a problem national in scope. States do and should protect their citizens but when large multistate insolvencies are at issue, the parochial needs of the states interfere with obtaining equitable treatment for all claimants. And the variations in state laws and capacity levels only serve to harm some consumers who are otherwise similarly situated.

The National Association of Insurance Commissioners, a private association, provides the only national quasi-regulatory coordination for insolvencies. In recent years, the NAIC has developed its accreditation program to inject uniformity into the insolvency regulation process. While this process has resulted in some significant changes at the state level and has brought more uniformity to the regulation of insurance, as the General Accounting Office (GAO) recently stated, "NAIC's ability to successfully sustain the program over the long term without the inherent au-

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[5] NOLGHA, *supra* note 4.

[6] *Id.*

thority to enforce its standards" is questionable.[7] GAO referred to NAIC as a "catalyst" for encouraging state departments to do better but the public needs more than a catalyst, it needs a regulatory structure with power to enforce standards.

A national system more responsive to the public is needed to assure accountability and oversight. As stated previously, only through a uniform system of guaranty fund and receiverships can all consumers be assured of a fair deal when insolvencies strike. We believe that a national guaranty fund and receivership system is appropriate to address weaknesses in the system. Whether a national guaranty fund system is developed through a national fund created by federal statute or through the promulgation of federal minimum standards for the states to adopt, the system must provide the following:

- Risk-based, prefunded system: The funds should be available at the time insolvencies occur to avoid unnecessary delay and hardship on claimants. The insolvent insurer, currently not assessed for its own insolvency, should be brought into the funds through a pre-assessment mechanism. And assessments should be based on some level of risk to more appropriately allocate the costs of insolvencies to the causes.
- Public participation in the process: The public must be an integral part of the guaranty fund and receivership system. A critical first step toward ensuring this is to require any governing board or committee involved in the system be comprised of members of the public as well as consumer representatives.
- Spreading the costs of insolvencies in a more equitable fashion: Taxpayers should not bear the bulk of the burden. Costs should be more equally distributed among policyholders, equity owners and company bottom lines.
- Assurance of continuation of coverage: In the area of health insurance policyholders of insolvent insurers are forced back into a market where prices may be too high to afford or, depending upon the person's health condition, may not be available at all. Any guaranty system should address this issue by ensuring continuation of coverage. A national health care system, which we support, would alleviate this problem.
- Uniformity in coverage: The system must assure all consumers an appropriate level of coverage for most products sold as insurance.
- Uniform and efficient data collection and analyses with an entity specifically charged to compile and analyze data and issue reports to the public: Information and analysis is crucial for regulators and the public alike. In order to assess the effectiveness of insolvency regulation and the safety net system, we need an entity to develop expertise and to be able to translate information into simplified form for public consumption.
- Consumers must be informed about the guaranty fund system: With the publicity generated by the insolvencies of recent years, many more consumers are now aware of the guaranty fund system but few know the specifics. Consumers, the industry and regulators all agree that consumer information and disclosure is a necessary element for the system.

The current guaranty fund system lacks public participation and accountability. Many of the decisions affecting the public, which bears the cost of the system, are made by the industry which may and often does have conflicting goals and interests. Relying on a state-based system in the wake of huge, nationwide insolvencies causes inequitable treatment among policyholders and claimants. It also results in unnecessary delays and inefficiencies that ultimately harms the public and consumers. Only through a national system with an entity specifically charged with overseeing and studying the process can consumers be assured of equitable and fair treatment to all.

Senator METZENBAUM. Thank you very much.

The Chair owes the previous panel an apology. I certainly intended to swear both panels.

Do you solemnly swear to tell the truth, the whole truth and nothing but the truth, and that includes the statements heretofore made?

Ms. GRIFFIN. I do.

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[7] "The National Association of Insurance Commissioners' Accreditation Program Continues to Exhibit Fundamental Problems," testimony of United States General Accounting Office, before the House Committee on Energy and Commerce, Subcommittee on Oversight and Investigations, June 9, 1993, at 17.

Mr. BELTH. I do.

Senator METZENBAUM. Thank you. Mr. Belth, happy to have you with us once again to share some of your thoughts on this subject.

STATEMENT OF JOSEPH M. BELTH

Mr. BELTH. Thank you, Mr. Chairman. I am Joseph M. Belth, professor of insurance in the School of Business at Indiana University. I will be professor emeritus of insurance beginning July 1. I am also editor of The Insurance Forum, and author of Life Insurance, a Consumer's Handbook.

I have written extensively about policy transfers. The views expressed in this statement are mine. I do not represent any organization or other individual.

Beginning in the fall 1989, I wrote several articles in the Insurance Forum about policy transfers. In some of those articles, I discussed Security Benefit's annuities. Information about the role of the State guaranty associations was important because the associations eventually provided most of the funds to settle the annuities.

The State guaranty associations were established to protect policy owners from losses when insurance companies fail. In this case, the evidence suggested that Security Benefit was obligated to the owners of the annuities. Therefore, the associations were used to provide financial assistance to Security Benefit, a financially strong company.

Security Benefit had attempted to extinguish its obligations under the annuities by transferring them to another company, which later failed. However, the evidence suggested that Security Benefit's obligations to the owners of the annuities were not extinguished.

Also, in October 1992, a Federal district court judge, in a strongly worded decision, held Security Benefit liable to the owner of the single largest annuity in the block. The role of the guaranty associations in the Security Benefit case was important because there were questions about whether the associations should have been involved at all.

In Pennsylvania, for example, the guaranty association statute provided for coverage of transferred policies only when assumption certificates were issued and Life of Pennsylvania did not send assumption certificates to the annuity owners.

Information was difficult to obtain. My impression from the experience is that the guaranty associations operate secretly. They do so, although they are established through State statutes. Their activities have a significant effect on many policy owners. And their actions often involve public funds through the tax offset provisions in the guaranty association laws of many States.

The guaranty associations are not State agencies. Therefore, they are not subject to open meeting requirements that must be met by State agencies and are not subject to open records laws that apply to State agencies. The associations operate in a shadowy world of their own, do not have to justify their actions, and are not accountable to the public.

I welcome this hearing because it may shed some light on the activities and operations of the associations.

Mr. Chairman, that concludes my summary. I request that the remainder of my statement, together with the exhibits, be included in the record of the hearing. I'll try to answer any questions you may have.

Senator METZENBAUM. Without objection your entire statement will be included in the record.

[Mr. Belth submitted the following:]

PREPARED STATEMENT OF JOSEPH M. BELTH

THE SECURITY BENEFIT ANNUITIES

In October 1986, a block of "ValuBuilder" single-premium deferred annuities that had been issued by The First Pyramid Life Insurance Company of America (Arkansas) was transferred to Security Benefit Life Insurance Company (Kansas) through a so-called assumption reinsurance agreement. At the time of the transfer, First Pyramid was a subsidiary of Security Benefit. In April 1987, the block of annuities was transferred from Security Benefit to Life Assurance Company of Pennsylvania. In December 1987, the block was transferred from Life of Pennsylvania to Diamond Benefits Life Insurance Company (Arizona).

The annuity owners were not notified of the October 1986 transfer until November 1986. They were not notified of the April 1987 transfer until June 1988, when they were also notified of the December 1987 transfer. They were not informed of the implications of the transfers, and they were not informed of their common law contractual rights; they were not told of their right to reject the transfers, they were not told that Security Benefit's obligations could be extinguished only with the consent of the annuity owners, and they were not asked to give their consent.

The agony of the annuity owners began in January 1989, when they were informed that Diamond Benefits was insolvent and had been seized by Arizona regulators. For almost four years, the annuity owners were unable to obtain access to their funds, and could not even obtain reports on their account balances.

Immediately after the seizure of Diamond Benefits, protracted litigation began between Life of Pennsylvania and the Diamond Benefits receiver over the question of whether the transfer from Life of Pennsylvania to Diamond Benefits was valid. While that litigation was in progress, matters were complicated further when Life of Pennsylvania was seized by Pennsylvania regulators in November 1990.

At the time of the April 1987 transfer, Security Benefit officials apparently were aware of the shaky financial condition of Life of Pennsylvania. A memorandum dated May 1, 1987 was mentioned on page 409 of the printed record of your May 5, 1992 hearing. The memorandum was from Archie Dykes, then Security Benefit's president and chief executive officer, to Dale Oldham, then the company's vice president for administration. The memorandum, apparently referring to Life of Pennsylvania, said: "Dale, we need to watch our liabilities with this company. I'm afraid they may go under. Archie."

THE NAIC RESOLUTION

At the December 1990 meeting of the National Association of Insurance Commissioners (NAIC), a resolution was adopted concerning the ValuBuilder annuities. The resolution said Security Benefit had "voluntarily agreed to contribute" $1.6 million ("contingent upon approval of their Board of Directors"), and urged the National Organization of Life and Health Insurance Guaranty Associations (NOLHGA) and its members "to take immediate action to provide the necessary funds to satisfy covered contractual obligations" to the annuity owners on or before January 15, 1991. The matter was finally resolved late in 1992, almost two years after the date in the resolution, and almost four years after the annuity owners found themselves in limbo upon the seizure of Diamond Benefits.

SECURITY BENEFIT'S DISCLOSURES

In its financial statements, Security Benefit provided very little information about the ValuBuilder annuities. In the annual statement for the year ended December 31, 1990 (filed March 1, 1991), this discussion under "contingent liabilities" in the "notes to the financial statements" was the only reference to the ValuBuilder annuities:

> The Company is currently involved in litigation concerning a closed block of single-premium deferred annuities that was acquired by the Company in

> 1986. The annuities were reinsured by the Company with Life Assurance Company of Pennsylvania (LACOP) in early 1987. Subsequently, LACOP reinsured the same block of annuities with Diamond Benefits Life Insurance Company (DBL) in 1988. The present litigation stems from the failure of LACOP and DBL to pay claims to policyholders. The litigation involving the Company was filed in 1989 and is being vigorously defended. The Company has established a reserve of $1.6 million in recognition of any potential liability in excess of various state guaranty fund limits for this block of annuities.

The litigation referred to in the note was a class action lawsuit in Arkansas against Security Benefit on behalf of the owners of the ValuBuilder annuities. The figure of $1.6 million was the same as the figure in the NAIC's December 1990 resolution. The figure seems small in view of the fact that one annuity alone—the largest annuity in the block—had a value of about $4 million. Apparently Security Benefit was confident that the state guaranty associations would absorb most of the obligations. Although Security Benefit appears to have been obligated to the owners of the annuities to the full extent of the annuity values, the company did not disclose that the total liabilities associated with the ValuBuilder annuities was about $29 million.

A discussion of the ValuBuilder annuities also appeared in Security Benefit's annual statement for the year ended December 31, 1991 (filed March 1, 1992). The first five sentences were the same as in the previous year's statement. Here is the remainder of the discussion:

> The Company, along with the National organization of Life and Health [Insurance] Guaranty Associations and the statutory receivers of DBL and LACOP, has agreed on a plan for resolution of nearly all policyholder claims. It is anticipated that this plan be put in place and finalized during 1992. The Company has established a reserve of $4.6 million in recognition of any potential liability in excess of various state guaranty fund limits for this block of annuities.

The involvement of NOLHGA was mentioned, and the reserve was increased to $4.6 million. There was no mention of the ValuBuilder annuities in Security Benefit's annual statement for the year ended December 31, 1992 (filed March 1, 1993); by that time the settlement involving the guaranty associations had been consummated, and the settlement also ended the class action lawsuit in Arkansas.

CORRESPONDENCE WITH SECURITY BENEFIT

It was difficult to obtain information directly from Security Benefit. Following publication of one of my articles, Security Benefit sent a form letter to persons who made inquiries after reading the article. The letter, dated February 3, 1992 and signed by Louis R. Jicha, second vice president for annuity marketing and sales, is on pages 400 and 401 in the printed record of your May 5, 1992 hearing. Mr. Jicha avoided discussion of some important points in my article. For example, he did not mention the failure to obtain the consent of the annuity owners to the transfer and that Security Benefit therefore appeared to remain obligated to them.

I wrote to Roger K. Viola, senior vice president and general counsel of Security Benefit, and asked some questions about Mr. Jicha's letter. In his reply, Mr. Viola said there were "numerous statements" in my article "that we view as inaccurate," said the company "had decided not to engage in an exchange of correspondence," and offered to meet with me in Topeka "at a mutually convenient time."

In my next letter, I said I wanted to identify those "numerous statements," explained it would be difficult and expensive to travel to Topeka, and offered to meet by telephone. In his reply, Mr. Viola did not identify the "numerous statements." Although he eventually agreed to meet by telephone on April 10, he imposed these conditions:

> We want you to know before the telephone conference takes place that we plan to record the call. Of course, you are free to do likewise. Please understand that we are not willing to discuss this matter with you if anyone else will be on the line when we speak. Finally, if after the conference call is completed you want to include in any future publication a quote made by one of our representatives, we require that we be given the opportunity to review the article prior to its publication and that we have the right to require you to delete or revise anything that in our opinion is quoted out of context. I need to receive written confirmation from you before April 10 to the conditions set forth in this letter.

I did not reply to Mr. Viola's letter, because his conditions for the telephone meeting were so outrageous that I decided not to dignify them with a response. On April 10, shortly after the time he had specified for the telephone meeting, he left a message on my answering machine. He invited me to call, and said nothing about his conditions.

I then wrote to Mr. Viola expressing surprise at the message, because he had said he would not meet without my prior agreement to his conditions. I indicated a willingness to meet by telephone provided he imposed no conditions whatever, and asked him to suggest some convenient times. I received no reply.

THE NAIC

The NAIC is a private association and is not subject to state statutes governing access to public records. Therefore I had no basis on which to demand access to the NAIC file on the ValuBuilder annuities.

NOLHGA

NOLHGA is a private association and is not subject to state statutes governing access to public records. Therefore I had no basis on which to demand access to NOLHGA's file on the ValuBuilder annuities.

THE GUARANTY ASSOCIATIONS

In February 1992, I decided to write directly to some of the guaranty associations, and asked NOLHGA for a list of addresses. Suzanne Fulton of NOLHGA complied with my request, but said in a covering note: "Please do not publish this list." Although I never had any intention of publishing the list, the note was puzzling.

I wrote to the guaranty associations in thirteen states (other than Arizona and Pennsylvania) with significant liabilities under the ValuBuilder annuities. I requested evidence of the decision to participate in the agreement covering those annuities. A sample letter is in Exhibit 1.

Six associations answered my letter; three of them complied with my request. Here were the six responses:

> Arkansas: A letter from Allan W. Horne, together with minutes of a special meeting. See Exhibits 2 and 3.
>
> Illinois: A letter from Robert F. Ewald refusing my request. See Exhibit 4.
>
> Kentucky: A letter from William W. Stodghill, together with two documents. See Exhibits 5, 6, and 7.
>
> Maryland: A letter from Joseph R. Petr. See Exhibit 8. He enclosed the letter Ms. Fulton had written to me. Her letter is discussed below.
>
> North Dakota: A handwritten note from James C. Beckstrom. He said: "We are waiting to hear if courts in Arizona and Pennsylvania have given approvals to a solution to this long-standing matter. This association's participation would be through NOLHGA, and I refer you to them for copies of any documents in this matter."
>
> Ohio: A handwritten note from Frank A. Gartland. He said: "I do not believe we are subject to any such statute [governing access to public records]. However, I have no objection to sending you the enclosed materials which you requested. If you have any further questions, give me a call." He enclosed excerpts from the minutes of a meeting. See Exhibit 9. He also sent four executed documents I had seen previously in the Arizona court records.

Seven guaranty associations did not reply. The nonrespondents were the associations in Florida, Indiana, Kansas, Missouri, Oklahoma, Tennessee, and Texas.

I sent Ms. Fulton a sample of the letters I had written to the guaranty associations. In response, she sent me a four-page letter quoting extensively from an earlier letter written by Eden Sarfaty, the former president of NOLHGA. Although I appreciated the information, I did not and still do not understand Mr. Sarfaty's reasoning. See Exhibit 10.

THE ATTORNEYS

It is my impression that Security Benefit's attorneys became heavily involved shortly after the seizure of Diamond Benefits, and that their task was to arrange for the guaranty associations to assume most of the responsibility for the annuities. At least two law firms were involved: Lord, Bissell & Brook of Chicago and Mitchell,

Williams, Selig & Tucker (later Mitchell, Williams, Selig, Gates & Woodyard) of Little Rock.

According to Security Benefit's annual statements, the amount paid to the two firms in the years 1990, 1991, and 1992 combined was about $2.6 million (about $1.6 million to Lord, Bissell & Brook and about $1 million to the Mitchell firm). The statements do not reveal what portion related to the ValuBuilder annuities, but I suspect that those annuities accounted for the bulk of the expense.

The attorneys accomplished their objective of minimizing the impact of the ValuBuilder annuities on Security Benefit. Although the company had sufficient statutory net worth to absorb the entire $29 million of obligations to the annuity owners, it would have been a major hit. Security Benefit's statutory net worth was about $70 million at the end of 1990, $83 million at the end of 1991, and $106 million at the end of 1992.

I believe that Security Benefit's attorneys orchestrated the agreement with NOLHGA and the guaranty associations every inch of the way. I believe that they developed the NAIC resolution, arranged for its adoption by the NAIC, participated in meetings of the guaranty associations, convinced the associations to assume responsibility for the bulk of the obligations under the ValuBuilder annuities, and developed the settlement agreement. They lost the lawsuit involving the largest single annuity in the block, but they were successful in delaying a class action lawsuit on behalf of the annuity owners until the settlement agreement involving the guaranty associations could be consummated.

JOSEPH M. BELTH, EDITOR,
THE INSURANCE FORUM,
Ellettsville, IN, March 2, 1992.

Mr. GERALD HUDGENS,
Arkansas Life and Disability Insurance Guaranty Association,
Providential Life Insurance Co., Little Rock, AR.

DEAR MR. HUDGENS: This is a request in accordance with the Arkansas statute governing access to public records.

This request relates to the annuities originally issued by First Pyramid Life and later transferred to Security Benefit Life, then to Life of Pennsylvania, and finally to Diamond Benefits Life. Please refer to the lead article in the enclosed reprint of the February 1992 issue of *The Insurance Forum.*

It is my understanding that your association has agreed to participate in the plan sponsored by NOLHGA. I request that you send me copies of the letter or other document evidencing your agreement to participate in the plan and your board resolution authorizing your participation.

I stand ready to pay your standard fees for locating and reproducing the requested documents.

Thank you for your assistance.

Sincerely yours,

JOSEPH M. BELTH,
Editor.

Enclosure.

DAVIDSON, HORNE & HOLLINGSWORTH,
A PROFESSIONAL ASSOCIATION,
Little Rock, AR, March 16, 1992.

Mr. JOSEPH M. BELTH,
The Insurance Forum,
Ellettsville, IN.

DEAR MR. BELTH: Your letter of March 2, 1992 and enclosure addressed to Gerald Hudgens, Chairman, Arkansas Life & Disability Insurance Guaranty Association, has been forwarded to us, as attorneys for the Association, for reply. You have requested "copies of the letter or other document evidencing your agreement to participate in the plan and your board resolution authorizing your participation." Your request is made pursuant to the "Arkansas statute governing access to public records." Please be advised that the Arkansas Freedom of Information Act ("FOI Act") applies only to Arkansas residents. It is my understanding that you are not an Arkansas resident. Secondly, pursuant to Arkansas law, records of the action of the Board of Directors of the Association may be made available only upon a vote of the majority of the Board. These laws are designed for the protection of policyholders which,

among other things, require confidential treatment of information to safeguard the financial integrity of insurers at certain times and during certain proceedings.

Notwithstanding the above, your request has been presented to the Board and the Board has authorized me as its attorney to furnish you with the information you have requested. Accordingly, I am enclosing herewith a copy of the Minutes of a Special Meeting of the Board held on September 4, 1991 wherein participation in the "NOLHGA Proposal to Satisfy Obligations to Holders of Value Builder Annuities Purportedly Assumed by Diamond Benefits Life Insurance Company" was authorized. I find no letter or other writing in my file and have concluded NOLHGA was orally notified of this action. The Association has not actually signed a participation agreement, but execution of the participation agreement has been authorized upon receipt of certain pertinent information, including the amount apportioned to the Association for inclusion in the participation agreement. This information and the enclosure is furnished to you as an accommodation and should not be taken as a waiver of the laws described above, as it may be necessary to rely upon such laws in the future for the protection of Arkansas residents and policyholders.

Yours very truly,
Davidson, Horne, & Hollingsworth,

ALLAN W. HORNE,

Enclosure,
cc: Gerald V. Hudgens.

ALLAN W. HORNE,
ARKANSAS LIFE AND DISABILITY INSURANCE GUARANTY ASSOCIATION,
Little Rock, AR, September 4, 1991.

A special meeting of the Board of Directors of the Arkansas Life and Disability Insurance Guaranty Association (the "Association") was held by conference telephone call at 10:00 a.m. on September 4, 1991 pursuant to notice given within the time and in the manner provided by the Association's Plan of Operation. All of the members of the Board were present in person at the meeting except Harry Leggett (Arkansas National Life Insurance Company) and Mark White (Arkansas Blue Cross and Blue Shield, A Mutual Insurance Company). Also present at the meeting were State Insurance Commissioner Lee Douglass, Frank B. Sewall, Allan W. Horne and Chet Roberts. Allan W. Horne was designated as acting secretary of the meeting in the absence of Mark White.

The Chairman announced the existence of a quorum and declared the meeting open for business. He stated that the purpose of the meeting was to consider a proposal of the National Organization of Life and Health Insurance Guaranty Associations ("NOLHGA") entitled "NOLHGA Proposal to Satisfy Obligations to Holders of Value Builder Annuities Purportedly Assumed By Diamond Benefits Life Insurance Company". The Proposal, a copy of which had been previously furnished to all members of the Board, was discussed at length. Dick Horne advised that he had discussed the proposal with representatives of NAIC, NOLHGA, other state guaranty associations ("SGA's"), had gathered and reviewed pleadings, briefs, memoranda, and other documents relative to litigation pending in Arizona between Life Assurance Company of Pennsylvania ("LACOP") and Diamond Benefits Life Insurance Company ("DBL") and had conducted legal research to determine whether or not the Association could legally participate in the proposal. He expressed the opinion that, based upon his review of various documents and legal research, the Association could legally participate in the Proposal. Commissioner Douglass agreed that the Association could legally participate in the Proposal and that for various reasons it was in the best interest of the Association to participate in the Proposal. Thereupon, upon motion of Lynn Jenkins, duly seconded by Ben Hyneman, the following resolution was adopted by the unanimous vote of all directors present at the meeting except James L. Judd who abstained because of a potential conflict of interest:

> BE IT RESOLVED, by the Board of Directors of the Arkansas Life and Disability Insurance Guaranty Association (the "Association") that the Association participate in the "NOLHGA Proposal to Satisfy Obligations to Holders of Value Builder Annuities Purportedly Assumed By Diamond Benefits Life Insurance Company" presented to the Association's Board of Directors at a special meeting of the Board held on September 4, 1991. The officers of the Association and its legal counsel are authorized and directed to notify NOLHGA of the Board's decision to so participate and to do all things necessary and appropriate to implement and consummate such participation.

There being no further business to come before the meeting, the meeting was adjourned.

Respectfully submitted,

ALLAN W. HORNE,
Secretary of the Meeting.

APPROVED:

GERALD V. HUDGENS,
Chairman.

ROBERT F. EWALD,
ILLINOIS LIFE AND HEALTH INSURANCE GUARANTY ASSOCIATION,
Chicago, IL, March 5, 1992.

Mr. JOSEPH M. BELTH,
The Insurance Forum,
Ellettsville, IN.

DEAR MR. BELTH: In response to your letter dated March 2, 1992, the Association is not subject to the Illinois statute governing access to public records, and we decline to release records of any transactions of the Association.

Sincerely,

ROBERT F. EWALD,
Executive Director.

WILLIAM W. STODGHILL,
GREENEBAUM TREITZ BROWN & MARSHALL,
Louisville, KY, March 23, 1992.

Mr. JOSEPH M. BELTH,
The Insurance Forum,
Ellettsville, IN.

Re: NAIC/NOLHGA Proposal re Security Benefit Life (SBL), Diamond Benefits Life (DBL) and Life Assurance Company of Pennsylvania (LACOP) Disputed Assumptions of SPDAs

DEAR MR. BELTH: This responds to your request dated March 2. I enclose my memorandum to the KLHIGA Board of Directors under date of July 1, 1991 along with confirmation of our Board's approval to participate in the settlement dated July 29, 1991.

I would call your attention to the conditions set forth in my memorandum which underlie the Board's approval and in particular the condition that all courts of appropriate jurisdiction ultimately approve the settlement.

Sincerely yours,

WILLIAM W. STODGHILL,

WWS: vs/1329
Enclosures
cc: KLHIGA Directors

WILLIAM W. STODGHILL,
KENTUCKY LIFE AND HEALTH INSURANCE GUARANTY ASSOCIATION,
Louisville, KY, July 29, 1991.

Ms. SUZANNE FULTON,
NOLHGA,
Herndon, VA.

Re: NAIC/NOLHGA Proposal re Security Benefit Life (SBL), Diamond Benefits Life (DBL) and Life Assurance Company of Pennsylvania (LACOP) Disputed Assumptions of SPDAs

DEAR SUZANNE: This will confirm our Board's approval of this Association's participation in the settlement of the above captioned matter.

Sincerely,

WILLIAM W. STODGHILL,

WWS: vs/1044
bcc: Mr. Clair Manson

KENTUCKY LIFE AND HEALTH INSURANCE GUARANTY ASSOCIATION

MEMORANDUM

PROMPT RESPONSE REQUESTED

TO: Clair Manson, Edward Reiter, Theodore Rich, Travis Cochran, Wendell Gunn, Edwin Chestnut, Sr.

FROM: William W. Stodghill

DATE: July 1, 1991

RE: NAIC/NOLHGA Proposal re Security Benefit Life (SBL), Diamond Benefits Life (DBL) and Life Assurance Company of Pennsylvania (LACOP) Disputed Assumptions of SPDAs

I enclose NOLHGA's memorandum dated June 7 proposing a settlement to be participated in by all affected state associations. The memorandum includes an executive summary as well as a spreadsheet illustrating the estimated cost of each party's participation in the event the proposal is effected. Also enclosed is my memorandum of January 22 of this year written when the idea of settlement first arose.

PLEASE LET ME HAVE YOUR APPROVAL OF THE PROPOSAL, OR IF YOU DISAPPROVE. YOUR COMMENTS ON OR BEFORE CLOSE OF BUSINESS ON JULY 10. IF APPROVAL IS LESS THAN UNANIMOUS, A SPECIAL MEETING, TELEPHONIC OR OTHERWISE, MAY BE NECESSARY.

SBL (Kansas) is currently licensed and in good standing in the state of Kentucky. LACOP (Pennsylvania) was licensed in the state of Kentucky up to the date of its insolvency. DBL (Arizona) has never been licensed in Kentucky. The Arizona and Pennsylvania associations both operate under the original NAIC model. With the exception of the annuities in question both associations are performing their obligations to protected persons wherever residing.

The existing litigation among the three insurers brings into question the effectiveness of state regulation with respect to transfers of business by assumption reinsurance. The protracted delay in meeting obligations to policy owners caused by the litigation brings into question the efficacy of state guaranty associations. This situation is further aggravated by the filing of class actions on behalf of the annuity contract holders to force a solution including the triggering of the state guaranty associations.

Last January when the proposal was in its early stages I suggested to Mr. Sarfaty the need to consider what rationale the Board and Commissioner could use for triggering other state associations when, but for their own dispute, the Arizona and Pennsylvania associations would have had full responsibility for all contract holders. When I phoned Eden earlier this week to discuss the question I was provided with his letter of June 25 to the Chairman of the Virginia association dealing with that question as well as expressing the viewpoint that settlement would be less expensive than the prospect of each association having to deal with the matter independently. Copy of that letter enclosed.

If we participate, the basis for assessment would be a Class B assessment predicated upon the insolvency of LACOP and settlement of a disputed claim.

I recommend that we agree to participate subject to the following limitations: (1) all other associations participate except those with a clearly valid excuse such as no guaranty act in force at the date of the respective insolvencies of DBL and LACOP; (2) that in any event our projected share of liability of $178,339 not be substantially increased; (3) that all conditions of the proposal related to legitimizing the action to be taken by the "Other Associations" such as we, be satisfied and (4) best efforts be made through the auspices of ACLI, NALC or other trade sources to inform the industry at large in order to minimize the potential for member insurer protests of assessments made by the "Other Associations."

WWS/1002
Enclosures
cc: Hon. Elizabeth P. Wright,
Stephen B. Cox, Esq.,
John S. Moyse,
Eden Sarfaty, NOLHGA.

JOSEPH R. PETR,
ADMINISTRATIVE DIRECTOR,
Townson, MD, April 20, 1992.

Mr. JOSEPH M. BELTH,
The Insurance Forum,
Elletsville, IN.

DEAR MR. BELTH: Your letter concerning ValuBuilders Annuities has been noted. Will you please refer to the enclosed letter dated March 9, 1992 from NOLHGA explaining the association's position in this matter.

Very truly yours,

JOSEPH R. PETR,
Administrative Director.

JRP/kbg
Enclosure

NOLHGA,
HERNDON, VA, MARCH 9, 1992.

Mr. JOSEPH M. BELTH,
The Insurance Forum
Ellettsville, IN.

Re: Global Settlement re. ValuBuilder Annuities

DEAR MR. BELTH: Thank you for sharing with me a copy of your recent request to several guaranty associations. The circumstances surrounding this transfer of a block of policies between two insurers which subsequently were placed in liquidation are very unusual. As you know, in December 1990, the NAIC Executive Committee asked NOLHGA to step in and immediately marshall the development of a plan to protect the annuitants involved because, at that time, policyholders had been waiting for approximately two years for a determination of liability for coverage. We would like to point out that our efforts have resulted in a creative solution to a unique and complex situation.

So that you may have a more complete understanding of the rationale for guaranty associations' participation in a global settlement of coverage of the "ValuBuilder" annuities, I am including the text of a letter written by Eden Sarfaty last summer to a number of guaranty associations who inquired about their statutory authority to enter into such an agreement:

> Following up on our conversation earlier today, I would like to offer some additional thoughts in response to your questions concerning whether the— Life and Health Insurance Guaranty Association has the authority to enter into the proposed settlement with various other guaranty associations, the receivers of Diamond Benefits and Life Assurance Company of Pennsylvania, and Security Benefit Life, under which through contributions by these parties the holders of so called "Valubuilder" SPDAs would be made whole through an assumption reinsurance agreement with Security Benefit Life.

In brief, the questions are: can the guaranty association fund payments to contract holders if it is not certain that the policies or contracts in question are the legal liability of an impaired or insolvent member insurer of such guaranty association? Secondly, can the guaranty association provide coverage if, under the guaranty statutes of the state of domicile of the impaired or insolvent insurer, coverage appears to be provided by the domiciliary guaranty association?

The proposal contemplates that orders determining insolvent each of DBL and LACOP will have been issued by the DBL and LACOP receivership courts. As either DBL or LACOP (or both) is a member insurer of each proposed participating association, the statutory predicate under the guaranty laws to assure payment of contractual obligations or provide benefits or coverages in respect of at least one of DBL or LACOP will have been satisfied.

A key feature of the proposal is the determination in the DBL and LACOP receivership courts that, without any specific finding as to actual liability in respect to the SPDAs, the facts are such that a finding of joint and several liability of SBL, LACOP and DBL is possible. This determination by the DBL and LACOP receivership courts of possible liability of DBL and LACOP for the SPDAs, combined with the statutory triggering of the associations in respect to DBL or LACOP, provide sufficient basis for the associations' participation in the proposal.

In all versions of the Model Life and Health Insurance Guaranty Association Act, coverage is to be provided to resident policyholders or contract holders of an im-

paired or insolvent member insurer, unless coverage is provided by the association of another state. The unique facts of this case are such that no coverage will be provided by the association of another state (Arizona or Pennsylvania) for this block of business unless and until it can be definitively adjudicated that either DBL or LACOP is legally responsible to the SPDA contract holders, or that DBL, LACOP and SBL are jointly and severally liable therefor.

Although the Arizona and Pennsylvania associations each cover non-residents, the absence of a determination as to actual liability for the SPDAs on the part of DBL or LACOP would appear to preclude a finding in respect of any Other Association (which finding could preclude participation in the proposal) that protection is provided to residents of such other associations' states by the domiciliary state. Similarly, the solvency of SBL would not appear to preclude participation of the Other Associations as there would merely have to be a determination that a finding of liability of SBL is possible, which determination provides a basis for SBL's participation in the proposal. Moreover, absent the proposed settlement, it is possible that inconsistent determinations as to the liability of DBL, LACOP or SBL could be entered by the Arizona and Pennsylvania receivership courts, and, indeed by other courts as well.

In brief, the answers are, for each participating guaranty association ("Other Association") other than the Arizona and Pennsylvania associations:

- each Other Association has an impaired or insolvent member company which may be fully liable for the SPDAs at issue
- each Other Association can not say that such impaired or insolvent member insurer was not liable, in whole or in part, for such contract
- each Other Association is primarily responsible to provide coverage to its own residents
- coverage is not being provided by another guaranty association (the guaranty associations of the domiciliary states of the insolvent insurers)
- the guaranty laws are to be liberally construed to effect their purposes
- the guaranty associations are authorized to enter into contracts and to settle claims
- the proposed settlement provides better coverage to the contract holders (they get full contract value) than would be provided if either the Arizona or Pennsylvania associations provided the coverage, or each Other Association provided coverage on its own without the proposed settlement
- the proposed settlement is less expensive for each Other Association than providing coverage for its residents without the settlement.

In conclusion, there is adequate legal predicate for providing coverage to resident contract holders, especially in the context of a settlement. As a matter of business judgement, the settlement is highly advantageous to each of the potentially affected associations.

As I reported to you on the telephone recently, Mr. Belth, all of the guaranty associations which were identified last year as being affected by virtue of having ValuBuilder residents in their state have expressed their commitment to this plan for coverage. Most of these associations have subsequently sent NOLHGA their signed participation agreements. Others are awaiting the exact figure on their state's share. The order of liquidation on Diamond Benefits Life and the Participation Agreement were approved by the Arizona Court on February 28, 1992. Also, the Commonwealth Court in Pennsylvania must approve this Agreement. A hearing has been set for March 12 regarding the petition which was filed with that court on February 28th. Once approved, we may proceed toward closure, which includes assumption of the block by Security Benefit Life.

As you know, the NAIC Liquidation and Guaranty Fund Working Group plans to discuss this plan, among other topics, on March 16 in Kansas City. Mr. Blame will attend that meeting. It is unfortunate that you will not be able to attend, given your keen interest in these matters.

Please feel free to call if you have any questions.

Very truly yours,

SUZANNE T. FULTON

Enclosures
cc: Jack Blaine
Arnold Dutcher w/enclosure

Senator METZENBAUM. Mr. Belth, 98 percent of guaranty fund board members represent insurance companies. Does that raise an

obvious potential for conflicts of interest between the industry and the public which is underwriting the funds?

Mr. BELTH. Yes, I believe that does raise a very serious question, Mr. Chairman.

Senator METZENBAUM. You say you had very great difficulty getting information on the SBL settlement from the guaranty funds. Do they routinely refuse to cooperate?

Mr. BELTH. In my statement, I alluded to letters that I wrote to 13 guaranty associations concerning asking for evidence of their agreement to participate in the Security Benefit Annuity case. Seven of the 13 simply did not respond. And of the other six, three provided the documents that I requested and three did not.

Senator METZENBAUM. Your statement says that your attempts to get information were frustrated because the guaranty funds, NOLHGA, and the NAIC are not subject to State Freedom of Information Acts. Would applying those acts to the funds benefit consumers?

Mr. BELTH. Yes, I believe it would, Mr. Chairman. These organizations operate in a partially public sense, and it would be desirable to have their records available to the public simply to increase the degree of their accountability. But I question that it would be feasible to sweep in private associations such as the NAIC and NOLHGA into open records laws, but I suppose anything is possible.

Senator METZENBAUM. Let's see, NAIC consists of a group of men and women who are public officials. It seems to me you could bring them within the sweep of open accountability.

Mr. BELTH. It is possible, I suppose, but it would probably take a special type of legislation.

Senator METZENBAUM. Probably a stronger lobby than the public has in this area.

Mr. Blaine, let me ask you, Professor Belth has just addressed himself to the subject of openness. Would NOLHGA be willing to open its records to the public? And if not, why not?

Mr. BLAINE. Our records primarily consist of an audited financial statement, and I have no problem making that available. We send it out to all of our members.

As far as the transactions in which we're involved, that would give me a considerable amount of difficulty, Mr. Chairman. First of all, in order to understand that, I have to explain the process.

We become involved when a company is taken over by an insurance commissioner and put into rehabilitation. That process is subject to court approval in an open forum, before a public court in the State in which the company is domiciled. In our involvement in arranging for the continued insurability or insurance of those policyholders, we typically do that through a sale of the business, or pay the claims, all of which is subject to an agreement that requires court approval.

So this is not a transaction that is not open to public scrutiny. In fact, those of you who are familiar with Executive Life in California know that we have in excess of 2 years of public scrutiny of the entire process.

Now during part of that process, Mr. Chairman, it is essential that we do not operate in public because we are in a bidding proc-

ess with competing companies who may wish to acquire that company. We may be privy to information on the insolvent company which is not available to the public, not because we don't make it available—not that we wouldn't—but because the insurance commissioner does not wish to make it available. It may be injurious to the company.

So in part, yes. In part of our transactions, they are public and appropriately so. In some of the deliberations they are not, and appropriately so.

Senator METZENBAUM. Let's assume that Professor Belth or Consumers Union or some other group wants to know what's going on at NOLHGA. What part of your conduct would be open to oversight, other than seeing some documentary papers? I'm talking about the deliberations.

Now I can understand some instances in which you might have to go into private or secretive sessions because there might be business matters involved, trade secrets, or it might involve one buyer against another buyer. But as I understand it right now, none of your deliberations are open to public.

Which ones could that part of the public interested in your deliberations, which meetings could we intend? I might be interested myself in attending.

Mr. BLAINE. I'm not intimately familiar with each of the State guaranty association board's operations, however I do know that at least one State, Arizona, it is a public agency, quasi-public, and has to have open meetings except where the State's sunshine laws permit closed meetings. I suspect that could be true in other States, where some board meetings might be open and some parts of them might be closed.

Senator METZENBAUM. Would you be good enough to have somebody compile for the committee a letter or some documentation as to which meetings are open and which would be closed in each of the respective States?

Mr. BLAINE. Yes, sir.

Senator METZENBAUM. Thank you.

One of your board members is William Wilson. Your literature says that he represents the Arizona Guaranty Association.

Mr. BLAINE. Yes, sir.

Senator METZENBAUM. Yet it shows him as working in Houston as the general counsel for the Variable Annuity Life Insurance Co. Does Mr. Wilson from Houston actually represent the people of Arizona?

Mr. BLAINE. No, sir. Mr. Wilson is on that board primarily because his company is licensed in Arizona. The model act on which most State laws are based does have a provision recommending that the board be representative of different sizes of companies and different locations in the country, so that you have in Arizona a board which represents domestic as well as foreign companies in that State.

Senator METZENBAUM. What you have here is the general counsel for an annuity life insurance company in Texas representing the people of Arizona on NOLHGA's board. Does that sound a little odd to you?

Mr. BLAINE. Our board qualification is only that they be a member of a State guaranty association board, and he qualifies by being a member of the Arizona board. It has nothing to do with the State of domicile of his company.

Senator METZENBAUM. You served on the NAIC's Advisory Committee on Guaranty Funds. You opposed the committee's recommending that two public representatives serve on the boards of each guaranty funds. Why do you oppose public representation?

Mr. BLAINE. I did not oppose public representation. I meant to correct the record. Ms. Griffin said that NOLHGA opposed public representation. Let me explain. I chaired an advisory committee at the request of the NAIC. The report that I wrote, and the reports that I have delivered publicly represent the collective votes of that committee, which were divided on that issue. I did not vote as chairman.

So my representation there was not—when I expressed the position of the committee, Mr. Chairman, I was not expressing my position or my organization. NOLHGA has taken no position on that issue. In fact, we are not a lobbying organization. We do not take legislative positions, except to explain and to provide technical expertise and testimony.

Senator METZENBAUM. Thirty-five percent of the members of the State guaranty fund boards of directors are not from the State on whose board they sit. Do you think that out of State board members should make decisions on how State tax revenues should be spent?

Mr. BLAINE. The board is representative of the member insurers in the State. Your question is to whether they should represent the residents of that State, when they're a foreign company? The composition of the board is not just to represent the residents of the State. The State insurance commissioner, who has oversight responsibility, represents the citizens of the State. Their function is to carry out the statutory duty of paying those residents when a company goes insolvent, and to insure that those obligations are met through the statutory scheme that's set up in that State.

Senator METZENBAUM. Ms. Griffin, you served on the NAIC's Advisory Committee on Governance of the Guaranty Funds. How many members were industry and how many were public representatives?

Ms. GRIFFIN. On the Government's committee there were approximately—I served on a couple of subcommittees. I'm not sure of the total. I guess the total would be 18 to 20. Out of those there was me as the consumer representative, the only public consumer representative, and there were probably 15 industry representatives, 16. Then I believe there were two from academia, but they didn't attend many of the meetings.

Senator METZENBAUM. You advocated the advisory committee recommend to the NAIC that public representatives be included on each guaranty fund board. How well did you do?

Ms. GRIFFIN. Not very. But let me clarify that. That advisory committee last year was approximately comprised of 20-some-odd members of industry and myself as a consumer rep. I don't think there were any academics. I was confused about the committee you were talking about.

I had suggested that the committee vote on public representatives. I proposed an amendment to the model act to provide for that. The first vote that went through was the vote on the concept—not my specific proposal—on the concept of public representation. There were only two who basically voted in favor of the concept.

I would just take a little bit of issue here with Mr. Blaine's characterization because I think that if that isn't opposing the concept—and I think he was a voting member, or I was not made aware that he was not a voting member of that committee. And as I stated, there were a variety of reasons why the committee believed that public representatives should not be put on the boards.

Senator METZENBAUM. I want to thank the members of this panel as well as the previous panel. This hearing stands adjourned. The record will remain open for 2 weeks. Senator Thurmond, does have some questions he'll submit.

[Whereupon, at 11:42 a.m., the subcommittee adjourned.]

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ISBN 0-16-045821-8
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